99TH CONGRESS
1st Session

SENATE

EXEC. REPT.
99-4

NAIROBI CONVENTION

DECEMBER 11 (legislative day, DECEMBER 9), 1985.—Ordered to be printed

Mr. LUGAR, from the Committee on Foreign Relations, submitted the following

REPORT

[To accompany Treaty Doc. 99-6]

The Committee on Foreign Relations, to which was referred the International Telecommunication Convention, with annexes, and a Final Protocol to the Convention signed on behalf of the United States at Nairobi on November 6, 1982, having considered the same, reports favorably thereon without amendment and recommends that the Senate give its advice and consent to ratification thereof.

PURPOSE

The Convention is the basic instrument of the International Telecommunication Union (ITU), a specialized agency of the United Nations. It establishes the purposes, structure and rules of procedure of the Union and provides the framework for the orderly and efficient conduct of international telecommunication services. The Convention is reviewed and revised as necessary at ITU Plenipotentiary Conferences, the most recent having been held in Nairobi in 1982.

SUMMARY

The Convention contains a preamble, two main parts comprising basic provisions and general regulations respectively, and three annexes. The basic provisions are those of a more permanent nature, setting forth the (1) composition, purposes and structure; (2) general telecommunications provisions; (3) special provisions for radio; (4) relations with the U.N. and other international organizations; (5) application of the Convention; (6) definitions; and (7) effective date and registration of the Convention.

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The general regulations in part two deal with the functioning and rules of procedure of the ITU, general provisions regarding conferences and the international consultative committees, the administrative regulations supplementing the Convention, and various other provisions such as languages and arbitration. The annexes provide (1) a list of ITU countries; (2) definitions of certain terms used in the Convention; and (3) the agreement between the United Nations and the ITU.

The Final Protocol, accompanying the Convention and forming part of the acts for which ratification is recommended, contains formal statements made at the time of signing the Convention in Nairobi. The United States submitted three such statements. The first was of a general nature, expressing concern about fiscal planning, politicization, and technical assistance in the ITU. The second, co-sponsored with 23 other countries, rejected the sovereignty claim of certain equatorial countries to parts of the geostationary satellite orbit. The third was entered in response to a Cuban statement related to U.S. broadcasting.

ANALYSIS OF THE CONVENTION'S ELEMENTS (by chapter)

1. *General:* Most of the provisions of the previous Convention (Malaga-Torremolinos, 1973, which entered into force for the United States on April 7, 1976) were carried forward without change. Some amendments proposed by other countries and adopted in Nairobi were not favored by the United States; however, the changes to the Convention were in all cases acceptable to the United States as negotiated.

2. *Preamble:* The concept of facilitating telecommunications was expanded to recognize its importance to preserving peace and to the social and economic development of all countries.

3. *Composition, Purposes and Structure:* The ITU's basic purposes to cooperate, improve and harmonize activities in the area of international telecommunications were expanded to include the promotion and offering of technical assistance to developing countries.

4. *General Telecommunications Provisions:* Fundamental principles dealing with the stoppage and suspension of services, secrecy of telecommunications, priority for safety of life communications, and similar were maintained without change.

5. *Special Provisions for Radio:* The need for ITU members to use the frequency spectrum and geostationary satellite orbit efficiently, equitably and economically, in conformity with the Radio Regulations, was maintained, as was the critical provision dealing with installations for national defense services.

6. *Relations with the United Nations:* The 1947 Agreement between the U.N. and the ITU, reproduced in Annex 3, was adopted without change.

7. *Application of the Convention and Regulations:* No changes were made to the provisions dealing with the execution, ratification, accession and denunciation of the Convention.

8. *Definitions and Effective Date:* The basic definitions, given in Annex 2, were retained without change. An effective date of 1 January 1984 for entry into force of the Convention was decided.

9. *Functioning of the Union:* Modest improvements were adopted in the detailed provisions regarding the various organs and conferences of the ITU, dealing primarily with fiscal responsibility and sound management.

10. *General Conference Provisions:* The detailed procedures for convening ITU conferences were simplified to achieve efficiencies in the Secretariat's duties.

11. *Provisions for International Consultative Committees:* The detailed description and responsibilities of the CCIR and CCITT were maintained with minimal change, since these provisions are more appropriately considered by the respective organs.

12. *Rules of Procedure for Conferences and Meetings:* The rules were revised to clarify the voting and debate procedures and to add new financial duties to the budget control committee.

13. *Other Provisions:* Arabic was added to Chinese, English, French, Russian, and Spanish as official languages of the ITU. Substantial new measures to ensure financial responsibility were imposed on conferences and meetings.

COMMITTEE ACTION

The State Department requested that the Committee consider the Convention expeditiously in order to meet the January 1986 deadline at which time the United States would lose voting rights in the International Telecommunication Union. In order to consider the matter quickly, the Committee requested the State Department to provide, in writing, information on a number of issues. This information, summarized below, provided the basis for the Committee's consideration given the impossibility of scheduling a hearing on short notice.

BACKGROUND

The Convention is the basic instrument of the International Telecommunication Union and provides the framework for the orderly conduct of international telecommunications. The United States has repeatedly determined that it is in the public and commercial interest to continue to play an active role within the ITU framework in light of our global leadership in telecommunications and the importance of this sector to our national security and economic interests. It is therefore of substantial importance to the United States to ratify the Convention.

There is an *increasing urgency* for ratification. The ITU carries out its work in various conferences and meetings, where decisions are taken on the basis of consensus whenever possible. Alternatively, issues are decided by voting on the basis of one-country, one-vote. *The United States will lose its right to vote,* but not its right to participate in conferences and meetings, if the ratification is not deposited before January 1, 1986.

Voting situations expected to arise in the ITU in the first half of 1986 which could adversely affect important U.S. interests include: (1) The Regional AM-Radio Conference in April to plan for ten new channels in the Americas. We are concerned that contentious voting situations may arise over issues dealing with United States-Cuba relations and our Central American policy; (2) The CCIR Plenary Assembly in May to adopt results of the four-year work program and elect a Director. A major U.S. objective is to re-elect Richard Kirby, a U.S. citizen, for another term in office. We consider this vote critical for the United States.

In the light of these and other issues of considerable significance, it is clear that U.S. interests in the ITU could be severely prejudiced if we are unable to vote.

MAJOR ELEMENTS OF AND CHANGES TO THE CONVENTION

The Nairobi Convention contains eighty-three articles divided into two parts (basic provisions and general regulations) and three annexes. It includes a Final Protocol to the Convention, signed on behalf of the United States at Nairobi. Also contained in the bound volume, but not requiring ratification, are Additional and Optional Protocols, Resolutions, a Recommendation and Opinions.

Most of the previous Convention, adopted in Malaga-Torremolinos in 1973, was carried forward without change. There were, however, a number of major changes, including those dealing with the ITU's role in technical assistance, Article 4 was modified to add a new basic purpose of the ITU ". . . to promote and to offer technical assistance to develop countries in the field of telecommunications . . ." and to ". . . foster international cooperation in the delivery of technical assistance to the developing countries . . ." Article 15, which deals with ITU finances, was modified to add technical cooperation and assistance to developing countries as one of the costs comprising the ordinary budget of the Union.

A group of changes proposed by the United States will promote greater fiscal responsibility in the ITU. The Administrative Council may now submit a financial plan to the next plenipotentiary conference and conduct annual budget reviews accompanied by a budget forecast for the following year. Administrative conferences, such as WARCs, are now required to take into account financial implications and to try to avoid taking decisions which might result in expenses in excess of authorized amounts.

Article 33, relating to the rational use of the radio spectrum and the geostationary orbit, was the object of proposals for radical change. The negotiated text requires taking into account the special needs of the developing countries and the geographical situation of particular countries. This is acceptable to the United States since the fundamental aspects of equitable and efficient use were retained.

COMPARISON WITH PAST CONVENTIONS

The 1982 Nairobi Conference became involved from the beginning in a extraneous and highly divisive attempt to exclude Israel from the conference. Contention and polarization carried over into the technical and substantive work, leaving inadequate time to consider the Union's purpose, organization and functioning. Changes to the Convention, while not fully aligned with U.S. proposals, did result in improvements. And all proposals that we strongly opposed were successfully rejected or reduced to an acceptable form.

The previous plenipotentiary in Malaga-Torremolinas in 1973 faced similar circumstances, with heavy political emphasis. Such issues as the status of South Africa, Portugal and Israel arose in all levels of the conference, also precluding a thorough review of the performance and effectiveness of the Union and it organs. The U.S. delegation to that conference, as in Nairobi, concluded that we should continue to play a leading role in the ITU, despite the difficulties.

SUPPORT FOR RATIFICATION

The Department of State strongly urges the Foreign Relations Committee and the Senate to give its early advice and consent to ratification of the 1982 Nairobi Convention. The Federal Communications Commission and the National Telecommunications and Information Administration, Department of Commerce, concur, as do other executive branch agencies (Defense, NASA and Transportation) which are major users of the radio spectrum. Informal consultation with industry and private sector entities that participate actively in ITU activities reveals that they also lend their strong support for timely ratification of the convention. There is no known opposition to ratification.

With respect to the urgency of ratification, there is a growing private sector awareness of the potential implications for upcoming ITU activities if the United States loses it vote. Of major interest are the Regional AM-Broadcasting Conference (broadcasters) and the CCIR Plenary Assembly (high definition television advocates).

CONCLUSIONS

The Department of State would have preferred a more businesslike, less political conference in Nairobi. The U.S. delegation expressed its general concern with three areas: (1) the lack of fiscal planning, (2) politicization, and (3) technical cooperation and assistance as a purpose of the Union.

Since the conference there have been positive signs in each of these areas. Recent meetings of the Administrative Council have taken initial measures to carry out better fiscal planning. Several radio conferences since Nairobi have carried out their work free from extraneous political issues. However, technical assistance activities funded through the ITU's ordinary budget remain an area of concern, although we are cautiously optimistic about the recent decision to establish a Center for Telecommunications Development.

We should also note that several things did not happen. Among these, the Conference retained the voluntary choice of contributory level, despite strong pressure to adopt a fixed assessment based on the United Nations scale. Further, it avoided including text in Article 33 which would have given preferential treatment for particular countries or groups of countries in the use of the frequency spectrum and orbit.

It was intentional that the Department, in consultation with other interested parties, did not submit the Nairobi Convention for ratification at an early date. The United States submitted a serious statement for the Final Protocol, which stated we were deeply troubled by events in Nairobi and reserved the right to make further specific statements prior to ratification. A thorough U.S. examination, lasting more than two years and taking into account all ITU activities during that period, resulted in a unanimous conclusion that overall U.S. interests would be best served by ratification.

At its December 11th business meeting, the Committee ordered the Convention favorably reported to the Senate for its advice and consent to ratification by a voice vote.

TEXT OF RESOLUTION OF RATIFICATION

Resolved, (two-thirds of the Senators present concurring therein), That the Senate advise and consent to ratification of the International Telecommunication Convention, with Annexes, and a Final Protocol to the Convention signed on behalf of the United States at Nairobi on November 6, 1982.

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99TH CONGRESS
1st Session

SENATE

EXEC. REPT.
99-5

INCOME TAX CONVENTION (AND PROTOCOL) WITH THE KINGDOM OF DENMARK

REPORT

OF THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

ON

EXECUTIVE Q, 96TH CONGRESS, 2D SESSION
TAX CONVENTION WITH THE KINGDOM OF DENMARK

AND

TREATY DOCUMENT 98-12, 98TH CONGRESS, 1ST SESSION
PROTOCOL AMENDING THE 1980 TAX CONVENTION WITH THE KINGDOM OF DENMARK

DECEMBER 11 (legislative day, DECEMBER 9), 1985.—Order to be printed

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99TH CONGRESS
1st Session

SENATE

EXEC. REPT.
99-5

INCOME TAX CONVENTION AND PROTOCOL WITH THE KINGDOM OF DENMARK

DECEMBER 11 (legislative day, DECEMBER 9), 1985.—Order to be printed

Mr. EVANS, from the Committee on Foreign Relations, submitted the following

REPORT

[To accompany Ex. Q, 96th Cong., 2d Sess., and Treaty Doc. 98-12]

The Committee on Foreign Relations, to which was referred the Tax Convention between the Government of the United States of America and the Government of the Kingdom of Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, together with a related exchange of notes, signed at Washington on June 17, 1980, and a Protocol Amending the Convention, together with an exchange of letters, signed at Washington on August 23, 1983 (hereinafter collectively referred to as the proposed treaty), having considered the same, reports favorably thereon without reservation and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

The principal purposes of the proposed income tax treaty between the United States and the Kingdom of Denmark are to reduce or eliminate double taxation of income earned by citizens and residents of either country from sources within the other country, and to prevent avoidance or evasion of the income taxes of the two countries. The proposed treaty is intended to continue to promote close economic cooperation between the two countries and to eliminate possible barriers to trade caused by overlapping taxing jurisdictions of the two countries. It is intended to enable the countries to cooperate in preventing avoidance and evasion of taxes.

II. BACKGROUND

The proposed treaty with Denmark was signed on June 17, 1980, and was amplified by an exchange of notes signed the same day.

The proposed protocol, together with a related exchange of notes, was signed on August 23, 1983. The proposed treaty would replace the treaty between the two countries, signed in 1948, that is currently in force.

The treaty was transmitted to the Senate for advice and consent to its ratification on September 4, 1980. The Committee postponed its consideration of the proposed treaty in 1981 at the Treasury Department's request because negotiation of the proposed protocol was then underway. The protocol was transmitted to the Senate for advice and consent to its ratification on November 16, 1983. In May 1984, the Committee reported favorably on the proposed treaty (and protocol) without reservation and recommended that the Senate advise and consent to its ratification. However, the Senate did not consider the treaty further in 1984. The proposed treaty was the subject of a hearing before the Committee on Foreign Relations on July 30, 1985.

III. SUMMARY

The proposed treaty is similar to other recent U.S. income tax treaties, the 1981 proposed U.S. model income tax treaty ("U.S. model treaty"), and the model income tax treaty of the Organization for Economic Cooperation and Development ("OECD model treaty"). However, there are certain deviations from those documents.

As in other U.S. tax treaties, the objectives of the treaty are principally achieved by each country agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other. For example, the treaty contains the standard treaty provisions that neither country will tax business income derived from sources within that country by residents of the other unless the business activities in the taxing country are substantial enough to constitute a permanent establishment or fixed base (Articles 7 and 14). Similarly, the treaty contains the standard "commercial visitor" exemptions under which residents of one country performing personal services in the other will not be required to pay tax in the other unless their contact with the other exceeds specified minimums (Articles 14, 15, and 18). The proposed treaty provides that dividends, interest, royalties, and certain capital gains derived by a resident of either country from sources within the other country generally may be taxed by both countries (Articles 10, 11, 12, and 13). Generally, however, dividends, interest, and royalties received by a resident of one country from sources within the other country are to be taxed by the source country on a restricted basis (Articles 10, 11, and 12).

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the treaty generally provides for the relief of the potential double taxation by the country of residence allowing a foreign tax credit.

This treaty contains the standard provision (the "saving clause") contained in U.S. tax treaties that each country retains the right to tax its citizens and residents as if the treaty had not come into effect (Article 1). In addition, it contains the standard provision that the treaty will not be applied to deny any taxpayer any benefits he would be entitled to under the domestic law of the country or under any other agreement between the two countries (Article 1); that is, the treaty will only be applied to the benefit of taxpayers.

The proposed treaty differs in certain respects from other U.S. income tax treaties and from the U.S. model treaty. It also differs in significant respects from the present treaty with Denmark. Some of these differences are as follows:

(1) U.S. citizens are generally covered regardless of whether they are also U.S. residents. While the U.S. model treaty covers U.S. citizens regardless of residence, the United States has frequently been unable to negotiate coverage for nonresident citizens in its income tax treaties.

(2) The U.S. excise tax on insurance premiums paid to a foreign insurer is generally covered. This is a departure from the present treaty and other older U.S. tax treaties, although similar coverage appears in some more recent treaties, such as the present treaties with France and Hungary. The excise tax on premiums paid to foreign insurers is covered under the U.S. model treaty.

(3) The proposed treaty defines the "United States" and "Denmark" more broadly than the present treaty to include expressly the U.S. and Danish portions of the continental shelf. Coupled with other treaty provisions, these definitions generally allow each country to tax certain income earned by residents of the other from the exploitation of natural resources, such as oil, found along the first country's portion of the continental shelf. Under the present treaty, there may be some uncertainty as to whether one country may tax natural resource income of residents of the other from operations along the first country's portion of the continental shelf.

(4) The proposed treaty does not provide investors in real property in the country not of their residence with an election to be taxed on those investments on a net basis. Under the present treaty, an election may be made or revoked on an annual basis without restrictions. The U.S. model treaty has a net basis tax election for income from real property; however, under the U.S. model, the election, once made, is binding for all subsequent years unless the countries agree to allow the taxpayer to terminate it. Although current U.S. law and current Danish law independently provide for elective net basis taxation, the making of a second election under internal U.S. law is restricted once a first election has been revoked.

(5) Under the proposed treaty, as amended by the proposed protocol, U.S. residents generally receive an imputation credit against Danish tax with respect to dividends received from Danish resident companies. This provision reflects Denmark's introduction in 1976 of an imputation system that integrates in part the corporate income tax with the individual income tax. Under this system, Danish resident shareholders subject to full tax liability in Denmark on dividends from Danish resident companies receive an imputation credit. The credit is either applied against the shareholder's Danish income tax liability or, if the credit exceeds such liability, is refunded to the shareholder. In the absence of a tax treaty, nonresidents of Denmark do not receive the imputation credit.

Under the proposed treaty, U.S. portfolio investors (U.S. resident companies owning less than a 25 percent share capital interest, and noncorporate U.S. residents) in Danish resident companies generally will be entitled to a credit equal to 15 percent of gross dividends beneficially owned. Under the treaty, Denmark may charge U.S. portfolio investors a withholding tax on the aggregate amount of dividends and credit at a rate not exceeding 15 percent. In the case of U.S. direct investors (U.S. resident companies owning at least a 25 percent share capital interest) in Danish resident companies, the proposed treaty generally provides for a credit equal to five percent of gross dividends beneficially owned. Denmark may charge U.S. direct investors a withholding tax on the aggregate amount of dividends and credit at a rate not exceeding five percent.

Absent the treaty, dividends paid to U.S. residents by Danish companies would be subject under present Danish tax rules to a withholding tax at a rate of 30 percent, rather than the five and 15 percent rates prescribed. Generally, the imputation credit, coupled with the reduced withholding tax, reduces the effective Danish tax rate on dividends beneficially owned by U.S. portfolio investors to 2.25 percent, and on dividends beneficially owned by U.S. direct investors to one-quarter of one percent.

The U.S. income tax treaties with the United Kingdom and France also provide certain U.S. resident shareholders an imputation credit.

(6) The proposed treaty, like the U.S. model treaty and the present treaty, generally limits to five percent the rate of withholding tax that the country of source may impose on dividends paid to direct investors resident in the other country. To qualify for the five-percent rate under the proposed treaty, the beneficial owner of the dividends must directly hold at least 25 percent of the share capital of the payor corporation. Under the U.S. model treaty, by comparison, the beneficial owner of the dividends must own 10 percent or more of the payor corporation's voting stock to qualify for the five-percent treaty rate. To qualify for the five-percent rate under the present treaty, the dividend recipient must be a corporation controlling 95 percent or more of the entire voting power of a payor corporation whose gross income from dividends and interest other than from its own subsidiaries is not more than 25 percent of its total gross income, and the relationship of the two corporations must not have been established primarily to secure the reduced rate of tax. Thus, the proposed treaty imposes a lower ownership requirement for application of the five-percent rate of tax on direct investment dividends than does the present treaty.

(7) The U.S. model treaty allows one country to tax dividends paid by a resident company of the other country if profits of its permanent establishment in the first country constitute 50 percent or more of the company's worldwide income. The proposed treaty allows such taxation only when the dividends are (a) paid to a resident of the first country (and when that country is the United States, to a U.S. citizen) or (b) with respect to a stock holding that is effectively connected with a permanent establishment or a fixed base in the first country. The effect of this variation in the proposed treaty is to exempt from U.S. tax dividends paid by a Danish

company which, under Internal Revenue Code section 861(a)(2)(B), are from sources within the United States and would otherwise be subject to U.S. tax. To prevent third-country residents from using a Danish company to take advantage of this exemption, the proposed treaty allows one country to tax dividends paid by a resident company of the other country which derives income from the first country if more than 50 percent of the share capital of the company is owned by third country residents and the company was formed to take advantage of this treaty exemption.

(8) Both the U.S. model treaty and the proposed treaty provide for source country taxation of capital gains from the disposition of real property regardless of whether the taxpayer is engaged in a trade or business in the source country. The proposed protocol expands the proposed treaty (and U.S. model) definition of real property for these purposes to encompass "U.S. real property interests." This safeguards U.S. tax under the Foreign Investment in Real Property Tax Act of 1980 which applies to dispositions of U.S. real property interests by nonresident aliens and foreign corporations. U.S. real property interests include interests in certain corporations that hold real property.

(9) Under the proposed protocol, income tax imposed under the Danish Hydrocarbon Tax Act adopted in 1982 is a covered tax and will be treated as a creditable income tax for U.S. foreign tax credit purposes. The Hydrocarbon Tax Act taxes income from the extraction of hydrocarbons in Denmark, including its territorial sea and its part of the continental shelf. The tax is assessed separately from the regular income and corporate taxes. However, a deduction is allowed for income and corporate taxes paid, and other special deduction and allowance rules apply in computing income subject to the tax. The tax is imposed only on income of fields showing profits, at the rate of 70 percent of the aggregate income that is subject to the tax. In the absence of this provision, Danish income tax imposed on companies subject to the Hydrocarbon Tax Act may not be fully creditable under U.S. Treasury Department regulations.

(10) The proposed treaty exempts from source country taxation certain profits from the operation of ships or aircraft when earned from participation in a consortium. The U.S. model treaty extends its shipping and aircraft exemption to profits from participation in a pool or joint operating agency, but not explicitly to a consortium. Extending the exemption to consortiums makes the exemption available to the Scandinavian Airlines System consortium (SAS), which derives income in the United States through an agent.

The proposed treaty also exempts from U.S. tax remuneration of a Danish resident from employment aboard an aircraft operated internationally by SAS.

(11) The proposed protocol provides that an installation, drilling rig, or ship used for the exploration or exploitation of natural resources will be treated as a permanent establishment only if it lasts more than 12 months. Thus, for example, business profits attributable to a U.S. drilling rig located in the Danish sector of the North Sea will be taxable by Denmark only if the rig stays there more than 12 months. A comparable provision is included in the

U.S. model treaty but is not included in the present treaty or in a number of other U.S. income tax treaties.

The proposed protocol also provides that gains derived by an enterprise of one country from the deemed alienation of an installation, drilling rig, or ship used for the exploration or exploitation of natural resources will be taxable in that country only. Thus, gains from the removal of a U.S. drilling rig located in the Danish sector of the North Sea will not be taxable by Denmark regardless of whether the enterprise has a permanent establishment in Denmark. The U.S. model treaty and the present treaty do not have this special protection against so-called "balancing charges."

(12) Under the proposed treaty, remuneration from employment as a member of the crew of a ship or aircraft operated internationally by an enterprise of one country is taxable in that country as well as in the country of which the employee is a resident. Under the U.S. model treaty, by contrast, such remuneration is taxable only in the country of which the employee is a resident.

(13) The present treaty exempts from source country taxation the salaries of teachers from the other country who visit for two years or less. Under the proposed treaty and the U.S. model, these salaries are subject to the standard rules, ordinarily resulting in full source country taxation.

(14) The proposed treaty allows directors' fees and similar payments by a company resident in one country to a resident of the other country to be taxed in the first country if the fees are paid for services performed in the first country. The U.S. model treaty, on the other hand, treats directors fees as personal service income or as a distribution of profits. Under the U.S. model treaty (and the proposed treaty), the country where the recipient resides generally has primary taxing jurisdiction over personal service income and the source country tax on distributed profits is limited.

(15) The proposed treaty allows source country taxation of an entertainer or athlete who earns more than $3,000 there during a taxable year; the comparable amount in the U.S. model treaty is $20,000.

(16) Under the proposed treaty, child support payments by a U.S. citizen or U.S. resident to a Danish resident under 18 years of age pursuant to a Danish court decree may be taxed by Denmark, and the United States must allow a deduction for the payments. Under the U.S. model treaty, child support payments are generally taxable only in the country of residence of the payor. Child support payments are not deductible under U.S. internal law.

(17) The proposed treaty provides that, if certain conditions are met, contributions to a pension plan recognized for tax purposes in one country made by or for an individual resident of the other country who is not a citizen of the second country will be treated the same way for tax purposes in the second country as contributions made to a pension plan recognized for tax purposes in the second country are treated in the second country. Absent this provision, a U.S. citizen residing in Denmark would not be able to deduct contributions to a U.S. pension plan for Danish income tax purposes; the Committee understands that under Danish administrative practice, deductions for contributions to foreign pension

plans (other than those of certain countries) are not otherwise allowed.

(18) The proposed treaty's nondiscrimination provision differs from the U.S. model treaty's in that it protects all legal persons deriving their status as such from the United States, not U.S. citizens alone.

(19) Sanctions against treaty shopping by business organizations are imposed on a more restricted basis under the proposed treaty, as amended by the proposed protocol, than under the U.S. model treaty. The present treaty does not contain anti-treaty shopping rules. (See discussion under "Committee Comments," below.)

(20) The proposed treaty contains a provision requiring each country to undertake to lend administrative assistance to the other in collecting taxes covered by the treaty. This provision, carried over with minor modifications from the present treaty, is more detailed than the administrative assistance provision in the U.S. model treaty. Among other things, the proposed treaty provision specifies that one country's application to the other for assistance must include a certification that the taxes at issue have been "finally determined."

(21) The proposed treaty would enter into force after each country notifies the other that its constitutional requirements for entry into force have been satisfied and the later of the notifications is received. Under the U.S. model treaty, entry into force occurs upon the exchange of instruments of ratification. This departure from the U.S. model reflects the fact that Danish law, unlike the U.S. Constitution, does not require legislative ratification of certain international agreements concluded by the government. The Danish Parliament may delegate to the Danish executive branch the power to conclude binding international agreements and has done so in the case of agreements to avoid double taxation.

IV. DATE OF ENTRY INTO FORCE AND TERMINATION

Entry into force

The governments of the countries are to notify each other through diplomatic channels when the constitutional requirements for entry into force of the proposed treaty have been satisfied. Upon receipt of the later of the notifications, the proposed treaty will enter into force. Identical rules for entry into force apply to the proposed protocol. With respect to taxation of dividends at source, the proposed treaty and proposed protocol will be effective for dividends paid or credited on or after the first day of the second month next following the date or dates on which the treaty and protocol enter into force. With respect to the credits against U.S. tax allowed for Danish taxes under the proposed treaty, as amended by the proposed protocol, the treaty and protocol, after entering into force, will be effective retroactively for taxable years beginning after 1982. With respect to other income, the proposed treaty and proposed protocol will be effective beginning on or after the first day of January next following the date or dates on which the treaty and protocol enter into force.

The existing treaty is to be phased out as the proposed treaty becomes effective. When the proposed treaty becomes fully effective, the existing treaty will terminate. However, where any provision of the present treaty would have afforded any person greater tax relief than the proposed treaty, that provision of the present treaty will continue to have effect for one year after the date on which the provisions of the proposed treaty would otherwise have first had effect.

Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after five years from its entry into force by giving at least six months prior notice of termination through diplomatic channels. A termination will be effective with respect to income of taxable years beginning (or, in the case of taxation at source, amounts paid or credited) on or after the first day of January next following the date of termination specified in the notice of termination.

V. COMMITTEE ACTION

The Committee on Foreign Relations held public hearings, chaired by Senator Evans, on the proposed Danish income tax treaty and protocol, and on other proposed tax treaties, on July 30, 1985. The Committee considered the proposed treaty and protocol on December 4, 1985 and ordered them favorably reported by a vote of 17-0, with Senators Lugar, Helms, Mathias, Kassebaum, Boschwitz, Pressler, Murkowski, Trible, Evans, Pell, Biden, Sarbanes, Zorinsky, Cranston, Dodd, Eagleton, and Kerry voting in the affirmative, and no Senators voting in the negative.

VI. COMMITTEE COMMENTS

The Committee on Foreign Relations approved the treaty and protocol, but expressed its concern with Article 19(4) of the treaty, dealing with the deductibility of certain child support payments to Danish children, and with Article 17 of the treaty, dealing with limitations on treaty-shopping. The Committee also indicated its concern with the protocol provisions allowing U.S. residents a foreign tax credit for Danish hydrocarbon taxes. Finally, the Committee expressed concern with the interaction between the proposed treaty and the President's tax reform proposals.

Deductibility of child support payments

Under the proposed treaty, as a general rule, child support payments made by a resident of one country to a resident of the other country (who is a child under 18 years of age) pursuant to a written separation agreement or decree of divorce, separate maintenance, or compulsory support may be taxed only in the first country. However, when such payments are made by a citizen or resident of the United States to a resident of Denmark pursuant to a Danish court decree, the treaty provides that the payments may be taxed by Denmark and the United States must allow a deduction for the payments. This rule generally allows Denmark to impose its tax on child support payments; under Danish internal law, child support payments are taxable income to a child 15 years old or older and the payor may deduct such payments provided that they are made to a child 18 years old or younger. Under U.S. internal law, child support payments are not taxable income to the recipient (Code sec. 71(b)) and, absent this special treaty provision, the payor may not deduct such payments. Thus, in preserving the Danish statutory tax on child support payments, the treaty provides a U.S. tax deduction not otherwise allowed under the Code.

As it noted in its prior report on the proposed treaty, the Committee is deeply concerned with the granting of deductions to U.S. persons by treaty in cases where Congress has chosen not to do so under the Code. This is the first time that a deduction for child support payments, in particular, has been provided by treaty. The Committee does not believe that treaties are a proper forum for providing the deduction.

The Committee first expressed concern with the granting of deductions by treaty in connection with its 1981 consideration of the proposed income tax treaties with Canada, Israel, and Jamaica, which allow deductions not granted under the Code. The Committee notes that in 1981 the Chairmen of both the Senate Finance Committee and the House Ways and Means Committee expressed their general views that the United States should not give U.S. persons deductions by treaty.

According to the Treasury Department's Technical Explanation of the proposed treaty and protocol, the child support provision of Article 19 is intended to reconcile the conflicting Danish and U.S. internal laws governing the tax treatment of child support payments. In the opinion of the Committee, however, the reconciliation reached is one-sided in Denmark's favor: Denmark is allowed to continue to collect tax on certain child support payments, while the United States is required to allow a deduction not otherwise allowed under the Code for these payments, which could result in a minor revenue loss to the U.S. Treasury.

As stated in its previous report on the proposed treaty with Denmark, the Committee considered recommending a reservation on the child support provision. However, the child support provision was included in the proposed treaty before the 1981 treaty hearings, when the deduction issue was brought generally to the Committee's attention. As indicated above, it was at that time that the Committee first indicated its general disapproval of the granting of U.S. tax deductions by treaty. The Committee therefore decided not to recommend a reservation on the child support provision because the provision predates the Committee's 1981 expression of disapproval of special treaty deductions. The Committee wishes to reiterate, however, that in the future proposed treaty provisions that would grant U.S. persons deductions not otherwise allowed under the Code will bear a substantial risk of Committee disapproval.

Anti-treaty shopping provision

The proposed treaty contains a provision that limits the use of the treaty by third country residents. When a resident of a third country can use a treaty between the United States and a treaty partner to reduce his tax liability to either or both of the countries, that resident can obtain a reduction in U.S. tax without reciprocal benefits accruing to U.S. residents earning income in that third country. Unintended use of treaties can erode the U.S. tax base. This unintended use is referred to as "treaty shopping."

By repealing the U.S. gross withholding tax on interest paid to foreigners on certain portfolio indebtedness, the Tax Reform Act of 1984 limited treaty shopping incentives dramatically. Opportunities for treaty shopping remain, however, where the United States still imposes tax on interest paid to foreigners, and where the United States imposes tax on other payments, such as royalties.

The anti-treaty shopping provision of the proposed treaty is generally consistent with the anti-treaty shopping provisions in other recent U.S. tax treaties with developed countries, and is more restrictive than the anti-treaty shopping provisions in older U.S. treaties.

However, the provision is less strict than that of the current (1981) U.S. model, although the U.S. model provision is only one of several approaches that the Treasury Department considers satisfactory to prevent treaty-shopping abuses. For example, the provision generally limits the use of the treaty not, as the U.S. model does, to corporations 75 percent of whose stock is owned by persons who are residents of the treaty partner in which the corporation is a resident, but to corporations in which 50 percent ownership is shared by either residents of the treaty partner of which the corporation is a resident, residents of the other treaty partner, U.S. citizens, publicly traded companies that are residents of the two countries, the two countries themselves, or any combination of them. The treaties with Australia and New Zealand, ratified in 1983, maintain the U.S. model's 75 percent standard, but like the proposed treaty, they expand the class of qualified beneficial owners.

As another example, under the proposed treaty, a business organization is generally denied treaty benefits if more than 50 percent of its gross income is used to make interest payments to persons other than those just named. By contrast, under the 1981 U.S. model treaty, a business organization is denied treaty benefits if its income is used in substantial part to meet liabilities to third-country residents who are not U.S. citizens.

The Treasury Department's Technical Explanation of the proposed treaty and protocol indicates that interest payments will be considered to be "made" under the treaty's income-use rule with respect to an original issue discount obligation when interest accrues for Danish tax deduction purposes. The Committee believes that this interpretation of the "make payments" language is important to forestall a potential abuse under the anti-treaty shopping provision of the proposed treaty. Because the income-use rule of the proposed anti-treaty shopping provision refers to using income to make payments rather than to "meet liabilities," as the U.S. model does, third-country investors might (absent the Technical Explanation interpretation) claim that they could meet the test by indirectly lending to U.S. persons through an investing entity that is a resident of Denmark (and that satisfies the 50 percent ownership test discussed above) on an original issue discount basis. (In that case, it could be argued that the Danish investing entity would not literally "make payments" to the third-country investor until the original issue discount obligation of the Danish investing entity matures, the income-use rule would technically not be violated and, consequently, interest received by the Danish investing entity from the U.S. borrowers would arguably be eligible for the treaty exemption from U.S. tax.) The Committee believes that the Technical Explanation's interpretation of the rule is the correct one.

The Committee remains concerned that the liberalized anti-treaty shopping provision of the proposed treaty may permit treaty-shopping advantages when compared to the anti-treaty shopping provisions of some other treaties. Treaty-shopping potential in the case of Denmark may be more serious than in the case of some other U.S. treaty partners because of the absence of any Danish withholding tax on interest payments from a Danish conduit to third-country investors; Denmark is relatively unusual among U.S. treaty partners in not imposing a withholding tax on interest derived by nonresidents. Treaty-shopping potential is also a special concern in the case of Denmark because, under the proposed treaty, Denmark will tax dividends paid by Danish companies to U.S. shareholders at a very low effective rate. This reduction of the Danish tax that a U.S. owner of a Danish finance subsidiary would pay on dividends received from such a subsidiary could facilitate the use of such subsidiaries to borrow from third-country residents.

If treaty-shopping abuses develop after a treaty is ratified it may be difficult to address them. It has proved difficult to renegotiate treaties once abuses develop. However, it may be possible to curb unilaterally abuses that develop (for example, by amending the Internal Revenue Code).

The Committee recognizes that the proposed treaty contains other provisions which are advantageous to the United States, in particular the provision extending the Danish imputation credit for dividends to U.S. shareholders in Danish companies. Also, the existing treaty with Denmark does not contain an anti-treaty shopping provision, and the Committee is not aware of any treaty-shopping abuses under the existing treaty. Denmark is generally a high-tax country and has shown no interest in serving as an international finance center that would attract treaty-shopping. For these reasons, as noted in the Committee's previous report on the proposed treaty, the Committee did not contemplate a reservation on the anti-treaty shopping provision. However, the Committee wishes to stress again that it will closely scrutinize anti-treaty shopping provisions included in treaties negotiated in the future for treaty-shopping potential. The Committee believes it is important that consideration be given to possible interactions between proposed anti-treaty shopping provisions and the other provisions of the proposed treaty at issue, as well as the domestic laws of the other country. The Committee anticipates that the Treasury Department will interpret and apply the proposed treaty and other treaties in the manner most consistent with anti-treaty shopping goals.

Creditability of Danish hydrocarbon tax

Under the proposed protocol, Danish national income taxes imposed under the Danish Hydrocarbon Tax Act adopted in 1982, as well as substantially similar taxes that may be enacted later, are specifically included as creditable income taxes. The affected taxpayers are those that earn oil and gas extraction income from oil and gas wells situated within the Danish territorial limits. Generally the covered activities are conducted in the Danish sector of the North Sea, along the continental shelf.

One reason for the negotiation of the treaty credit for Danish hydrocarbon taxes was concern that the income taxes paid by companies subject to the Danish Hydrocarbon Tax Act would not be fully creditable under the present treaty between the two countries or under U.S. law. No specific determination has been made by the Treasury Department or Internal Revenue Service concerning the creditability of the Danish hydrocarbon tax under the Treasury Department's foreign tax creditability regulations, promulgated in October 1983.

A second reason for the negotiation of the treaty credit for Danish hydrocarbon taxes was that similar treaty credits are allowed for arguably comparable oil and gas taxes imposed by the United Kingdom and Norway (on income from some fields) under the U.S. income tax treaties with those countries currently in force. Because the United Kingdom and Norway are Denmark's North Sea competitors, Denmark argued that fairness required that it too be allowed a treaty credit for taxes on oil and gas extraction income.

The Committee remains sympathetic to the argument that fairness requires that Denmark be granted a credit for oil and gas taxes, given that similar credits are granted in the U.S. income tax treaties with the United Kingdom and Norway. The Committee also recognizes U.S. oil companies' need for certainty with respect to a significant tax issue such as the foreign tax credit. However, as it noted in its previous report on the proposed treaty, the Committee questions the wisdom of addressing these concerns through the treaty mechanism. The allowable treaty credit for Danish hydrocarbon taxes will probably be larger than the credit otherwise allowed under Treasury regulations, at least for taxable years in which the Danish income tax rate is less than the U.S. rate. During 1985 the Danish rate was increased, and now exceeds the U.S. rate. However, the treaty credit provision is effective retroactively for taxable years beginning after 1982. Thus, the treaty credit could reduce U.S. taxes collected from U.S. oil companies that operate in the Danish sector of the North Sea and that have incurred Danish hydrocarbon tax liability. While the "per-country" limitation imposed under the protocol on the amount of the treaty credit would reduce any such U.S. revenue loss, the per-country limitation would not eliminate it. Thus, the Committee emphasizes that the foreign tax credit provision of the proposed treaty is not to be regarded as a precedent for U.S. tax treaty negotiations with other countries.

The tax-writing committees have made it clear in the past that they do not think treaties are the appropriate vehicle for granting unilateral tax credits of the kind granted for Danish hydrocarbon taxes by the protocol. They have suggested that it would be more appropriate to handle unilaterally problems of the sort raised by the imposition of special oil and gas taxes by foreign countries. This Committee generally agrees and suggests that treaties not be used in the future to handle foreign tax credit issues which can best be dealt with either legislatively or administratively.

Coordination with tax reform proposals

The Committee is concerned about possible conflicts between the treaty and the current tax reform proposals. In particular, the proposed branch-level tax and dividends paid deduction could conflict with provisions of the treaty.

The United States does not now impose a branch-level tax, but the Administration's May 1985 tax reform proposal asks Congress to enact one. The proposed treaty does not expressly prohibit the United States from imposing a branch-level tax though it does prevent the United States from imposing its second tier withholding tax on dividends, which the branch-level tax would replace under the Administration's proposal. However, the nondiscrimination rule protecting permanent establishments that is found in the proposed treaty may effectively forbid the imposition of a branch-level-type tax on permanent establishments. The Administration has proposed that any such treaty protection not be overridden by Congress if it enacts a branch-level tax. On enactment, the Administration would instead seek to renegotiate treaties to allow the United States to impose the branch-level tax that Congress enacted as a general rule in particular countries where current treaties prohibit its imposition. The House Committee on Ways and Means (H.R. 3838, H. Rept. No. 99-426, Dec. 7, 1985) has approved a branch level tax similar to the Administration proposal. That provision would generally defer to existing treaties that prohibit a branch level tax, except in the case of a treaty-country corporation controlled by residents of a third country.

A similar potential issue is presented by the Administration's proposal to allow a 10-percent dividends paid deduction to U.S. corporations. The purpose of this deduction is to reduce the burden of the two-tiered taxation of corporate profits under the "classical" system of present law, which imposes a tax at the corporate and shareholder levels. The dividends paid deduction would extend to some dividends paid to foreign shareholders. Absent treaty protection, however, the proposal would impose on such dividends a compensatory withholding tax designed to prevent elimination of all tax on 10 percent of corporate profits where shareholders are not U.S. taxpayers. The proposed treaty with Denmark would prevent U.S. imposition of this compensatory withholding tax. The Administration proposal would not initially impose a compensatory tax on dividends paid to protected treaty country recipients, including Danish recipients. However, it would delegate to the Secretary of the Treasury the authority to override treaties to impose a compensatory dividend withholding tax on a country-by-country basis. The House Committee on Ways and Means (H.R. 3838) has approved a similar dividends paid deduction and compensatory withholding tax that would override treaties in certain cases.

Many countries which reduce the burden of the two-tier tax do so through a mechanism other than a dividends paid deduction. These countries, including Denmark, give resident shareholders a tax credit (often called an imputation credit) when they receive dividends. Denmark's partial tax credit for resident shareholders reflects the fact that corporate income, from which the dividends are paid, is subject to Danish corporate tax. For the shareholder, the credit may function as the economic equivalent of a partial dividends paid deduction. As indicated above, Denmark gives Danish resident shareholders subject to full tax liability in Denmark a credit equal to 25 percent of gross dividends paid by Danish resident companies. Denmark, like other countries, does not give this credit to foreign shareholders unilaterally. However, the proposed treaty provides substantial U.S. corporate investors with a reduced credit equal to five percent of gross dividends paid by Danish resident companies and other U.S. investors with a reduced credit equal to 15 percent of gross dividends paid by Danish resident companies. This provides a significant Danish tax reduction for U.S. shareholders in Danish corporations. Certain other U.S. income tax treaties with imputation system countries also provide the dividend credit to investors on a limited basis. Some U.S. treaties with such countries do not provide even a part of the credit to U.S. investors.

Under the Administration tax reform proposal, the Secretary of the Treasury could impose the compensatory withholding tax on a dividend paid to a treaty country recipient only if the home country of the recipient was unwilling to extend its own credit benefits to dividends paid by local companies to U.S. shareholders (or if there were treaty shopping concerns). The Committee on Ways and Means provision (H.R. 3838) would similarly override treaties to impose the compensatory withholding tax if the treaty country continued to deny equivalent relief (or if the treaty failed to place satisfactory limits on treaty shopping).

The Committee therefore wishes to make it clear that, in recommending Senate approval of the proposed treaty at a time when Congressional efforts to achieve major tax reforms are underway, the Committee expects that Congress' flexibility in the tax reform process will not be restricted by the treaty. The chairmen and ranking minority members of the tax-law writing Committees of the Congress emphasized in letters to this Committee the importance of clarifying that in the context of the reform effort now under way, Congress might find it necessary to exercise its prerogative to override some provisions of treaties, including those recently ratified, that are in conflict with the reforms. Therefore, although the Committee decided not to recommend a formal reservation or understanding with respect to this issue, it does wish to emphasize to our prospective treaty partners that if Congress decides to enact a branch-level tax or dividends paid deduction, Congress may not defer to the contrary provisions of any treaty in doing so.

VII. BUDGET IMPACT

The Committee estimates that the effect of the proposed treaty and protocol on budget receipts will be negligible. However, this estimate assumes that the provisions of the protocol providing for the creditability of Danish hydrocarbon taxes on oil and gas extraction income from oil or gas wells in Denmark will have no revenue impact, which would be the case if those taxes are creditable under existing U.S. law to the extent necessary to offset U.S. tax on that income. The Committee is not, however, making any judgment on whether those taxes would be so creditable, absent the protocol.

It should be noted that the treatment of companies subject to the Danish hydrocarbon tax under existing U.S. law is uncertain. Under the Treasury Department's new foreign tax creditability regulations, promulgated in October 1983, it is possible that income taxes imposed on companies subject to the Danish Hydrocarbon Tax Act would not be fully creditable.

Because Denmark raised its corporate tax rates during 1985, the Committee's analysis of the proposed treaty's budget impact differs slightly from the analysis in the Committee's previous report on the proposed treaty, which was written at a time when Denmark's corporate tax rate was less than the U.S. rate. The Committee believes that a significant revenue impact is less likely to be felt, given the Danish corporate tax rates now in effect. The protocol could have a significant long-range revenue impact only if income taxes imposed on companies subject to the Danish Hydrocarbon Tax Act would not be creditable in the absence of the protocol to the extent necessary to offset U.S. tax on that income. This could occur, for example, if Denmark were to lower its corporate tax or to grant more generous deductions. Revenue impact is not estimated to be significant through fiscal year 1990 in any event because U.S. oil companies' commercial production in the Danish sector of the North Sea is expected to remain low. It is not clear when any such revenue impact in question would occur, in the absence of the protocol, because it is unclear when substantial U.S. commercial production in the Danish sector of the North Sea will begin.

In accordance with the objectives of section 403 of the Budget Act, the Committee advises that the Director of the Congressional Budget Office estimates that the effect of the proposed treaty and protocol provisions on budget receipts through 1990 will be negligible, assuming that the Danish hydrocarbon taxes are creditable under current U.S. law to the extent necessary to offset U.S. tax. Under the opposite assumption, the Director of the Congressional Budget Office estimates that the proposed treaty and protocol could eventually have a significant revenue effect; however, it is unlikely that there would be any revenue effect before 1990.

In keeping with the spirit of section 308(a) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the Committee states that the treaty and protocol do not provide any new budget authority or any new or increased tax expenditures.

VIII. EXPLANATION OF TREATY PROVISIONS

A detailed article-by-article explanation of the proposed income tax treaty between the United States and Denmark is presented below. This explanation includes a discussion of the proposed protocol under the treaty articles amended by it. Also presented below are separate, summary explanations of the notes exchanged when the proposed treaty was signed, the proposed protocol, and the notes exchanged when the proposed protocol was signed.

Article 1. Personal Scope

The personal scope article describes the persons who may claim the benefits of the proposed treaty and contains other rules including the "saving clause."

The proposed treaty applies generally to residents of the United States and to residents of Denmark, with specific exceptions designated in other articles. This follows other U.S. income tax treaties, the U.S. model income tax treaty, and the OECD model income tax treaty. Residence is defined in Article 4.

The proposed treaty provides that it does not restrict any benefits accorded by internal law or by any other agreement between the United States and Denmark. Thus, the treaty will apply only where it benefits taxpayers.

Like all U.S. income tax treaties, the proposed treaty contains a "saving clause." Under this clause, with specific exceptions described below, the treaty is not to affect the taxation by either country of its residents or its citizens. By reason of this saving clause, unless otherwise specifically provided in the proposed treaty, the United States will continue to tax its citizens who are residents of Denmark, as if the treaty were not in force. "Residents" for purposes of the treaty (and thus, for purposes of the saving clause) include corporation and other entities as well as individuals (Article 4 (Fiscal Domicile)).

Under Section 877 of the Internal Revenue Code (the "Code") a former U.S. citizen whose loss of citizenship had as one of its principal purposes the avoidance of U.S. income, estate or gift taxes, will, in certain cases, be subject to tax for a period of 10 years following the loss of citizenship. The treaty contains the standard provision found in the U.S. model and most recent treaties specifically retaining the right to tax former citizens.

Exceptions to the saving clause are provided for certain benefits conferred by the articles dealing with pensions, alimony, and child support (Article 19); relief from double taxation (Article 23); nondiscrimination (Article 24); and mutual agreement procedures (Article 25).

In addition, the saving clause does not apply to the benefits conferred by one of the countries under the articles dealing with government service (Article 20), students and trainees (Article 21), and diplomatic agents and consular officers (Article 28), with respect to individuals who are not citizens of the conferring country and do not have "permanent resident status" in the conferring country. The term "permanent resident status" is intended to have the same meaning as the term "immigrant status" used in the corresponding provision of the U.S. model treaty. Thus, for U.S. purposes, an individual has permanent resident status in the United States if he has been admitted to the United States as a permanent resident under U.S. immigration laws (i.e., he holds a "green card").

Article 2. Taxes Covered

The proposed treaty generally applies to the income taxes of the United States and Denmark.

United States

In the case of the United States, the proposed treaty applies to the Federal income taxes imposed by the Internal Revenue Code, but excluding the accumulated earnings tax and the personal holding company tax. As amended by the proposed protocol, the proposed treaty also applies to the Federal tax imposed with respect to private foundations.

Under the Internal Revenue Code, premiums from insuring U.S. risks which are received by a foreign insurer having no U.S. trade or business are not subject to U.S. income tax but are subject to the U.S. insurance excise tax (Code secs. 4371-4373). This insurance excise tax is also covered by the proposed treaty, but only to the extent that the foreign insurer does not reinsure the risks in question with a person not entitled to relief from this tax under the proposed treaty or another U.S. treaty. Therefore, under the business profits article (Article 7) and other income article (Article 11), income of a Danish insurer from the insurance of U.S. risks will not be subject to the insurance excise tax if that insurance income is not attributable to a U.S. permanent establishment maintained by the Danish insurer (unless the risk is reinsured with a company not entitled to the exemption). This treatment is a departure from the existing tax treaty with Denmark, but is similar to that provided in some other recent U.S. tax treaties, for example, the treaties with France and Hungary. The excise tax on premiums paid to foreign insurers is a covered tax under the U.S. model treaty.

Under the Internal Revenue Code (in the absence of a contrary treaty provision), a foreign insurer is subject to U.S. income tax on income derived from the insurance of risks situated in the United States in situations where that insurance income is effectively connected with a U.S. trade or business. A foreign insurer insuring U.S. risks ordinarily will not be viewed as conducting a U.S. trade or business and thus will not be subject to U.S. income tax if it has no U.S. office or agent and operates in the United States solely through independent brokers.

In these situations, a foreign insurer is not subject to U.S. income tax, but the insurance excise tax is imposed (except as otherwise provided in a treaty) on the premiums paid for that insurance.[1] The excise tax may be viewed as serving the same function as the tax imposed on dividends, interest, and other types of passive income paid to foreign investors. In general, the excise tax applies to insurance covering risks wholly or partly within the United States where the insured is (i) a U.S. person or (ii) a foreign person engaged in a trade or business in the United States. Under the Code, the excise tax generally applies to any such life, sickness, or accident insurance, or annuity contract unless the foreign insurer is subject to U.S. income tax. It generally applies to any such casualty policy written by an insurer unless the policy is placed through an officer or agent of the foreign insurer within a State in which the insurer is authorized to do business.

The treatment of insurance income of foreign insurers is complicated somewhat in situations where, as is usually the case, some portion of the risk is reinsured with other insurers in order to spread the risk. In situations where the foreign insurer is engaged in a U.S. trade or business and thus subject to the U.S. income tax, reinsurance premiums, whether paid to a U.S. or a foreign reinsurer, are allowed as deductions. Accordingly, the foreign insurer is taxable only on the income attributable to the portion of the risk it retains. However, while no excise tax is imposed on the insurance policy issued by the foreign insurer doing business in the United States (and, in the case of casualty insurance, the policy is written by an officer or agent of the insurer within a State in which it is authorized to do business), the one-percent excise tax on reinsurance is imposed if and when that insurer reinsures that U.S. risk with a foreign insurer not doing business in the United States (and not subject to U.S. income tax).

The statutory rules governing the taxation of foreign insurers insuring U.S. casualty risks have been modified through interpretations of treaties contained in certain closing agreements which have been entered into between the IRS and a number of foreign insurers. The closing agreements are intended to provide relief in those situations where there is the potential for both income tax and excise tax liability because the foreign insurer is subject to the income tax (because it is engaged in a U.S. trade or business) and the excise tax (because it is not licensed by a State to write insurance). It is understood that, if there is a tax treaty between the United States and the country of which the foreign insurer is a resident and the treaty includes an appropriate non-discrimination clause, then the foreign insurer agrees in the closing agreement to subject itself to the U.S. income tax by treating its U.S. operations (frequently an unrelated agent) as a permanent establishment, and the IRS agrees to waive the excise tax on premiums effectively connected with that U.S. trade or business under the non-discrimination clause of the treaty.

In exempting from the U.S. income tax and the insurance excise tax all insurance income which is not attributable to a permanent establishment in the United States, the proposed treaty makes two changes in the statutory rules governing the taxation of insurance income of Danish insurers. First, any insurance income which is effectively connected with a U.S. trade or business but is not attributable to a U.S. permanent establishment will not be subject to U.S. income tax. This exemption is contained in the existing treaty. Second, Danish insurers not engaged in a U.S. trade or business will no longer be subject to the insurance excise tax. This exemption is not contained in the existing treaty. However, those Danish insurers which continue to maintain a U.S. permanent establishment after the proposed treaty enters into force will remain subject to the U.S. income tax on their net U.S. insurance income attributable to the permanent establishment.

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[1] The excise tax is presently imposed at a rate of four percent of the premiums paid on casualty insurance and indemnity bonds, and one percent of the premiums paid on life, sickness, and accident insurance, annuity contracts, and reinsurance (Code secs. 4371-4374).

In addition, the insurance excise tax will continue to apply in situations where a Danish insurer with a U.S. trade or business reinsures a policy it has written on a U.S. risk with a foreign reinsurer other than a resident of Denmark or another insurer entitled to exemption under a different tax treaty (such as the U.S.-French treaty). The tax is imposed on the Danish insurer which in this situation is viewed as the U.S. resident person transferring the premium to the foreign reinsurer. The excise tax will apply to such reinsurance even where the Danish insurance company has a U.S. trade or business but no U.S. permanent establishment and thus will not be subject to U.S. income tax on the net income it derives on the portion of the risk it retains.

If the excise tax applies to premiums paid to the Danish insurer in the absence of the treaty exemption, the tax will continue to apply to that insurer to the extent of reinsurance with a nonexempt person. For example, assume a Danish company not engaged in a U.S. trade or business insures a U.S. casualty risk and receives a premium of $200. The company reinsures part of the risk with a German insurance company (not currently entitled to exemption from the excise tax) and pays that German company a premium of $100. The four-percent excise tax on casualty insurance applies to the premium paid to the Danish insurance company to the extent of the $100 reinsurance premium. Thus, the U.S. insured is liable for an excise tax of $4, which is four percent of the portion of its premium to the Danish insurer which was used by the Danish insurer to reinsure the risk. It is the responsibility of the U.S. insured to determine to what extent, if any, the risk is to be reinsured with a nonexempt person.

Denmark

In the case of Denmark, the proposed treaty applies to the Danish national income taxes and municipal income taxes. The proposed protocol provides that the Danish national income taxes to which the treaty applies include the taxes imposed under the Danish Hydrocarbon Tax Act. The Danish Hydrocarbon Tax Act is discussed under Article 23.

Other rules

For purposes of the non-discrimination article (Article 24), the treaty applies to taxes of all kinds imposed by the countries, including any taxes imposed by their political subdivisions or local authorities. For purposes of the exchange of information article

(Article 26), the treaty applies to national taxes of every kind imposed by the countries.

The proposed treaty also contains a provision generally found in U.S. income tax treaties to the effect that it will apply to substantially similar taxes that either country may subsequently impose. The proposed treaty, like the U.S. model, obligates the competent authority of each country to notify the competent authority of the other country of any substantial changes in the tax laws of his country and of any official published material concerning the application of the treaty, including explanations, regulations, rulings, or judicial decisions.

Article 3. General Definitions

Certain of the standard definitions found in most U.S. income tax treaties are contained in the proposed treaty.

The term "person" is defined to include an individual, an estate or trust, a company and any other body of persons. A "company" is any body corporate or any entity which is treated as a company or body corporate for tax purposes.

An enterprise of a country is defined as an enterprise carried on by a resident of that country. Although the treaty does not define the term "enterprise" it will have the same meaning that it has in other U.S. tax treaties—the trade or business activities undertaken by an individual, partnership, company, or other entity.

The proposed treaty defines "international traffic" as any transport by ship or aircraft by a resident of one country, except where the transport is solely between places in the other country. Accordingly, with respect to a Danish enterprise, purely domestic transport in the United States is excluded.

The U.S. competent authority is the Secretary of the Treasury or his delegate. In fact, the U.S. competent authority function has been delegated to the Commissioner of Internal Revenue, who has redelegated the authority to the Associate Commissioner (Operations). The Assistant Commissioner (Examination) has been delegated the authority to administer programs for simultaneous, spontaneous, and industry-wide exchanges of information. The Director, Foreign Operations District (formerly called the Director of the Office of International Operations), has been delegated the authority to administer programs for routine and specific exchanges of information and mutual assistance in collection.

The Danish competent authority is the Minister for Inland Revenue, Customs, and Excise, or his authorized representative.

The "United States" means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam or any other U.S. possession. The definition of the United States also includes, where the term is used in a geographical sense, any area outside the territorial sea of the United States that, in accordance with international law and the laws of the United States, has been or may at a later time be an area within which the United States may exercise rights with respect to the exploration and exploitation of the natural resources of the seabed or its subsoil. The intent of this rule is to cover the U.S. continental shelf consistent with the definition of continental shelf contained in section 638 of the Code.

The term "Denmark" means the Kingdom of Denmark but does not include the Faroe Islands or Greenland. Denmark also includes, where the term is used in a geographical sense, any area outside the territorial sea of Denmark that, in accordance with international law and the laws of Denmark, has been or may at a later time be an area within which Demark may exercise rights with respect to the exploration and exploitation of the natural resources of the seabed or its subsoil. Therefore, income earned on the Danish continental shelf is covered.

The term "Contracting State" means the United States or Denmark, as the context requires.

The proposed treaty also contains the standard provision that, unless the context otherwise requires or the competent authorities of the two countries establish a common meaning, all terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty.

Article 4. Fiscal Domicile

The assignment of a country of fiscal domicile or residence is important because the benefits of the proposed treaty generally are available only to a resident of one of the countries as that term is defined in the treaty. Furthermore, double taxation is often avoided by the treaty assigning one of the countries as the country of residence where, under the internal laws of the countries, a person is a resident of both.

Under U.S. law, residence of an individual is important because a resident alien is taxed on his worldwide income, while a nonresident alien is taxed only on his U.S. source income and on his income that is effectively connected with a U.S. trade or business. Under the standards for determining residence provided in the Tax Reform Act of 1984 (which were generally effective on January 1, 1985), an individual who spends substantial time in the United States in any year or over a three-year period generally is a U.S. resident. A permanent resident for immigration purposes also is a U.S. resident. The standards for determining residence provided in the 1984 Act do not apply in determining the residence of a U.S. citizen for the purpose of any U.S. tax treaty (such as a treaty that benefits residents, rather than citizens, of the United States.) A company is a resident of the United States if it is organized in the United States.

The proposed treaty generally defines "resident of a Contracting State" to mean any person who, under the laws of that country, is liable to tax therein by reason of his domicile, residence, citizenship, place of incorporation, or any other criterion of a similar nature. However, the term "resident of a Contracting State" does not include any person who is liable to tax in that country in respect only of income from sources in that country.

This provision of the proposed treaty is generally based on the fiscal domicile article of the U.S. model treaty. Under this provision, citizenship alone may establish residence. As a result, U.S. citizens residing overseas (in countries other than Denmark) are entitled to the benefits of the treaty as U.S. residents. The proposed treaty is one of the few U.S. income tax treaties in which the

United States has been able to negotiate coverage for nonresident citizens.

In the case of income derived or paid by an estate or trust, the term "resident of a Contracting State" applies only to the extent that the income derived by the estate or trust is subject to tax as the income of a resident, either in the entity's hands or in the hands of its beneficiaries. For example, if the share of U.S. beneficiaries in the income of a U.S. trust is only one-half, Denmark would have to reduce its withholding tax on only one-half of the Danish source income paid to the trust.

A company is a "resident of a Contracting State" if it is created or organized under the laws of that country or a political subdivision of that country.

A set of "tie-breaker" rules is provided to determine residence in the case of an individual who, under the basic residence rules, would be considered to be a resident of both countries. Such a dual resident individual will be deemed to be a resident of the country in which he has a permanent home available to him. If this permanent home test is inconclusive because the individual has a permanent home in both countries, the individual's residence is deemed to be the country with which his personal and economic relations are closer, i.e., his "center of vital interests". If the country in which he has his center of vital interests cannot be determined or if he has no permanent home available to him in either country, he will be deemed to be a resident of the country in which he has an habitual abode. If the individual has an habitual abode in both countries or in neither of them, the competent authorities of the countries are to settle the question of residence by mutual agreement.

In the case of a person, other than an individual or a company, who is resident of both countries under the basic treaty definition, the treaty requires the competent authorities of the two countries to endeavor by mutual agreement to settle the question of residence and to determine how the treaty applies to that person.

Article 5. Permanent Establishment

The proposed treaty contains a definition of the term "permanent establishment" that generally follows the pattern of other recent U.S. income tax treaties, the U.S. model, and the OECD model.

The permanent establishment concept is one of the basic devices used in income tax treaties to limit the taxing jurisdiction of the host country and thus mitigate double taxation. Generally, an enterprise that is a resident of one country is not taxable by the other country on its business profits unless those profits are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties will apply, or whether those amounts will be taxed as business profits. Taxation of business profits is discussed under Article 7 (Business Profits).

In general, under the proposed treaty, a permanent establishment is a fixed place of business through which an enterprise engages in business in the other country. A permanent establishment includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or other place of extraction of natural resources. It also includes any building site or construction or installation project, if the site or project lasts for more than 12 months. In addition, under the proposed protocol, a permanent establishment includes any installation, drilling rig, or ship used for the exploration or exploitation of natural resources, if the installation, drilling rig, or ship lasts for more than 12 months. The 12-month period for establishing a permanent establishment in connection with a building site, an entity used for the exploration or exploitation of natural resources, etc., corresponds to the rule of the U.S. model treaty.

The current treaty does not contain special permanent establishment rules for building sites, entities used for the exploration and exploitation of natural resources, etc.

The general rule is modified to provide that a fixed place of business that is used for any of a number of specified activities will not constitute a permanent establishment. These activities include the use of facilities solely for storing, displaying, or delivering merchandise belonging to the enterprise and the maintenance of a stock of goods belonging to the enterprise solely for storage, display, or delivery, or solely for processing by another enterprise. These activities also include the maintenance of a fixed place of business solely for the purchase of goods or merchandise or for the collection of information, or solely for the purpose of carrying on, for the enterprise, any other preparatory or auxiliary activity. Under the U.S. model treaty, the maintenance of a fixed place of business solely for any combination of these activities will not constitute a permanent establishment. Under the proposed treaty, a fixed place of business used solely for any combination of these activities will not constitute a permanent establishment provided that the overall activity of the fixed place of business is of a preparatory or auxiliary character.

If a person has, and habitually exercises, the authority to conclude contracts in a country on behalf of an enterprise of the other country, then the enterprise will be deemed to have a permanent establishment in the first country. This rule does not apply where the contracting authority is limited to those activities (described above) such as storage, display, or delivery of merchandise which are excluded from the definition of permanent establishment. The proposed treaty contains the usual provision that the agency rule will not apply if the agent is a broker, general commission agent, or other agent of independent status acting in the ordinary course of its business.

The determination whether a company of one country has a permanent establishment in the other country is to be made without regard to the fact that the company may be related to a company that is a resident of the other country or to a company that engages in business in that other country. Such relationships are thus not relevant; only the activities of the company being tested are relevant.

Article 6. Income from Real Property

This article covers income from real property. The rules governing gains from the sale of real property are in Article 13.

Under the proposed treaty, income derived by a resident of one country from real property situated in the other country may be taxed in the country where the real property is located. Income from real property includes income from agriculture or forestry.

The term "real property" has the meaning which it has under the law of the country in which the property in question is situated. The term in any case includes property accessory to real property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of real property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources. Thus, income from real property will include royalties and other payments in respect of the exploitation of natural resources (e.g., oil). It does not include interest on loans secured by real property. Ships and aircraft are not real property.

The source country may tax income derived from the direct use, letting, or use in any other form of real property. These rules allowing source country taxation also apply to the income from real property of an enterprise and to income from real property used for the performance of independent personal services.

The present treaty, the U.S. model treaty, and certain other U.S. income tax treaties provide residents of one country with an election to be taxed on a net basis by the other country on income from real property in that other country. The proposed treaty does not contain that election, but a net basis election is provided for U.S. real property income under the Code (secs. 871(d) and 882(d)). The Committee understands that Denmark presently taxes income from real property on a net basis.

Article 7. Business Profits

U.S. Code rules

U.S. law distinguishes between the business income and the investment income of a nonresident alien or foreign corporation. A nonresident alien or foreign corporation is subject to a flat 30-percent rate (or lower treaty rate) of tax on certain U.S. source income if that income is not effectively connected with the conduct of a trade or business within the United States. The regular individual or corporate rates apply to income (from any source) which is effectively connected with the conduct of a trade or business within the United States.

The taxation of income as business or investment income varies depending upon whether the income is U.S. or foreign. In general, U.S. source periodic income (such as interest, dividends, rents, and wages), and U.S. source capital gains are effectively connected with the conduct of a trade or business within the United States only if the asset generating the income is used in or held for use in the conduct of the trade or business, or if the activities of the trade or business were a material factor in the realization of the income. All other U.S. source income of a person engaged in a trade or business in the United States is treated as effectively connected income.

Foreign source income is effectively connected income only if the foreign person has an office or other fixed place of business in the United States and the income is attributable to that place of business. Only three types of foreign source income can be effectively connected income: rents and royalties derived from the active conduct of a licensing business; dividends, interest, or gain from stock or debt derived in the active conduct of a banking, financing or similar business in the United States; and certain sales income attributable to a U.S. sales office.

Except in the case of a dealer, trading in stocks, securities or commodities in the United States for one's own account does not constitute a trade or business in the United States and accordingly income from those activities is not taxed by the United States as business income. This concept includes trading through a U.S.-based employee, a resident broker, commission agent, custodian or other agent, or trading by a foreign person physically present in the United States.

Proposed treaty rules

Under the proposed treaty, business profits of an enterprise of one country are taxable in the other country only to the extent that they are attributable to permanent establishment in the other country through which the enterprise carries on business. This is one of the basic limitations on a country's right to tax income of a resident of the other country.

The taxation of business profits under the proposed treaty differs from U.S. rules for taxing business profits primarily by requiring more than merely being engaged in a trade or business before a country can tax business profits, and by substituting an "attributable to" standard for the Code's "effectively connected" standard. Under the Code, all that is necessary for effectively connected business profits to be taxed is that a trade or business be carried on in the United States. Under the proposed treaty, on the other hand, some level of fixed place of business must be present and the business profits must be attributable to that fixed place of business.

The business profits of a permanent establishment are determined on an arm's-length basis. Thus, there are to be attributed to a permanent establishment the business profits which would reasonably be expected to have been derived by it if it were a distinct and independent entity engaged in the same or similar activities under the same or similar conditions. For example, this arm's-length rule applies to transactions between the permanent establishment and a branch of the resident enterprise located in a third country. Amounts may be attributed whether they are from sources within or without the country in which the permanent establishment is located.

In computing taxable business profits, deductions are allowed for expenses, wherever incurred, which are incurred for the purposes of the permanent establishment. These deductions include a reasonable allowance of executive and general administrative expenses, research and development expenses, interest, and other expenses which are incurred for purposes of the enterprise as a whole (or for purposes of that part which includes the permanent establishment). Thus, for example, a U.S. company which has a branch office in Denmark but which has its head office in the United States will, in computing the Danish tax liability of the branch, be entitled to deduct a portion of the executive and general administrative expenses incurred in the United States by the head office for purposes of operating the Danish branch.

Business profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by a permanent establishment for the account of the enterprise. Thus, where a permanent establishment purchases goods for its head office, the business profits attributed to the permanent establishment with respect to its other activities will not be increased by a profit element in its purchasing activities. The amount of profits attributable to a permanent establishment must be determined by the same method each year unless there is good and sufficient reason to change the method.

For purposes of the proposed treaty, the term "business profits" means income derived from any trade or business whether carried on by an individual, company, or any other person or persons. Specifically included in business profits under the proposed treaty are income from the rental of tangible personal (movable) property and income from the rental or licensing of cinematographic films or films or tapes used for radio or television broadcasting. The treaty definition of business profits, and the treaty business profits rules generally are similar to those provided in the U.S. model treaty.

Where business profits include items of income which are dealt with separately in other articles of the treaty, those other articles, and not this business profits article, will govern the treatment of those items of income. Thus, for example, dividends are taxed under the provisions of Article 10 (Dividends), and not as business profits.

Article 8. Shipping and Air Transport

As a general rule, the United States taxes the U.S. source income of a foreign person from the operation of ships or aircraft to or from the United States. An exemption from U.S. tax is provided if the ship or aircraft is documented under the laws of a foreign country that grants an equivalent exemption to U.S. citizens and corporations operating ships or aircraft documented under U.S. law. The United States has entered into agreements with a number of countries providing such reciprocal exemptions.

Under the proposed treaty, profits which are derived by an enterprise of one country from the operation in international traffic of ships or aircraft ("shipping profits") will be exempt from tax by the other country. International traffic means any transportation by ship or aircraft, except where the transportation is solely between places in one of the countries (Article 3(1)(d) (General Definitions)). Unlike the exemption provided in the present treaty, the exemption applies whether or not the ships or aircraft are registered in the first country. Thus, for example, Denmark would not tax the income of a U.S. resident operating a Liberian-flag vessel.

The exemption for shipping profits applies to profits from the rental on a full or bareboat basis of ships or aircraft if operated in international traffic by the lessee or if such rental profits are incidental to the actual operation of ships and aircraft in international traffic. (Rental on a full or bareboat basis refers to whether the ship or aircraft is leased fully equipped, manned and supplied, or not.) The exemption also applies to income derived from the use, maintenance, or rental of containers, trailers for the inland transportation of containers, barges, and other related equipment where the equipment is used to transport goods or merchandise in international traffic. In addition, the shipping and air transport provisions apply to profits from participation in a consortium, pool, joint business, or international operating agency. The term "consortium" was included to make clear that air transport profits of participants in the Scandinavian Airline Systems consortium are to be exempt from U.S. tax.

Article 9. Associated Enterprises

The proposed treaty, like most other U.S. tax treaties, contains an arm's-length pricing provision similar to section 482 of the Code which recognizes the right of each country to make an allocation of income to that country in the case of transactions between related enterprises, if an allocation is necessary to reflect the conditions and arrangements which would have been made between independent enterprises.

For purposes of the proposed treaty an enterprise of one country is related to an enterprise of the other country if one of the enterprises participates directly or indirectly in the management, control, or capital of the other enterprise. Enterprises are also related if the same persons participate directly or indirectly in their management, control, or capital.

The proposed treaty states that this provision is not intended to limit any law in either country which permits the distribution, apportionment, or allocation of income, deductions, credits, or allowances between non-independent persons when such law is necessary to prevent evasion of taxes or to reflect clearly the income of those persons. Thus, the proposed treaty makes clear that the United States retains the right to apply its inter-company pricing rules (Code section 482) and its rules relating to the allocation of deductions (Code sections 861, 862, and 863, and Treas. Reg. sec. 1.861-8).

When a redetermination of tax liability has been properly made by one country, the other country will make an appropriate adjustment to the amount of tax paid in that country on the redetermined income. In making that adjustment due regard is to be given to other provisions of the treaty and the competent authorities of the two countries will consult with each other if necessary. To avoid double taxation, the proposed treaty's saving clause retaining full taxing jurisdiction in the country of residence or citizenship will not apply in the case of such adjustments.

Article 10. Dividends

In general

This article contains a provision under which U.S. residents generally receive a credit against Danish tax with respect to dividends received from Danish resident companies. Subject to certain exceptions, the effect of this credit coupled with the reduced rates of withholding tax on dividends also provided in this article is to reduce to 2.25 percent the effective Danish rate of tax on dividends paid by Danish resident companies to U.S. portfolio investors (U.S. companies owning a share capital interest in the payor of less than 25 percent and noncorporate U.S. residents), and to reduce to one quarter of one percent the effective Danish rate of tax on dividends paid by Danish resident companies to U.S. direct investors (U.S. companies owning a share capital interest in the payor of 25 percent or more). The inclusion of this provision reflects Denmark's introduction in 1976 of a credit (or imputation) system for Danish resident shareholders and Danish resident companies which integrates in part the corporate income tax with the individual income tax. The integrated tax system of Denmark differs from the classical system of two-tiered corporate taxation used by the United States (under which dividends received by shareholders are generally taxed without regard to the taxes paid by the distributing corporation). The U.S. income tax treaties with the United Kingdom and France, countries which have imputation systems resembling that of Denmark, also contain imputation credit provisions. The imputation credit provision of the proposed treaty and Denmark's imputation system are discussed in more detail below.

U.S. and Danish dividend taxation rules

The United States imposes a 30-percent tax on the gross amount of U.S. source dividends paid to nonresident alien individuals and foreign corporations. The 30-percent tax does not apply if the foreign recipient is engaged in a trade or business in the United States and the dividends are effectively connected with that trade or business. In such a case, the foreign recipient is, like a U.S. person, subject to U.S. tax on a net basis at the standard graduated rates. U.S. source dividends, for purposes of the 30-percent tax, are dividends paid by a U.S. corporation (other than an "80/20 company" described in Code section 861(a)(2)(A)). Also treated as U.S. source dividends for this purpose are certain dividends paid by a foreign corporation, if at least 50 percent of the gross income of the foreign corporation, in the prior three-year period, was effectively connected with a U.S. trade or business of that foreign corporation. The tax imposed on the latter dividends is often referred to as the "second tier" withholding tax.

At present, Denmark similarly imposes a 30-percent tax on Danish source dividends. However, the Danish tax applies to all Danish source dividends whether paid to residents or nonresidents. The dividend tax paid by resident shareholders (fully liable to Danish tax) is set off against their final Danish tax. The dividend tax paid by nonresident shareholders is nonrefundable. It generally represents the final tax on the dividends imposed by Denmark.

Treaty reduction of dividend taxes

Under the proposed treaty, each country may tax dividends paid by its resident companies but the rate of tax is limited by the treaty if the beneficial owner of the dividends is a resident of the other country. Source country taxation is limited to five percent of the gross amount of the dividends if the beneficial owner of the dividends is a company which holds directly at least 25 percent of the share capital of the payor corporation. The tax is limited to 15 percent of the gross amount of the dividends in other cases involving dividends paid to residents of the other country.

The stock ownership threshold for the reduced tax rate of five percent on direct investment dividends was set at 25 percent of the share capital of the payor company, rather than 10 percent of the voting stock of the payor company as provided in the U.S. model treaty, at the request of Denmark, in order to conform the stock ownership threshold more closely to that of the OECD model and to Danish law. Share capital includes all shares, whether of preferred or common stock and whether or not they carry voting rights, but it does not include debt. Under the present treaty, the five-percent rate of tax on direct investment dividends applies if the shareholder is a corporation controlling, directly or indirectly, at least 95 percent of the entire voting power in the payor corporation, provided that not more than 25 percent of the gross income of the payor corporation is derived from interest and dividends other than from its own subsidiaries, and that the relationship of the two corporations was not established primarily to secure the reduced rate of tax. Thus, the proposed treaty imposes a lower percentage ownership requirement for application of the five-percent rate of tax on direct investment dividends than does the present treaty.

Imputation system and imputation credit

The effective rate of Danish tax on dividends paid by a Danish resident company and beneficially owned by a U.S. resident is reduced further by means of an imputation credit. This credit is available as long as Denmark's imputation system is in effect.

Under the Danish imputation system, Danish resident shareholders subject to full tax liability in Denmark on dividends from Danish resident companies generally receive a tax credit equal to a percentage of the gross dividend. The credit was 15 percent of the gross dividend for years of assessment 1978/79 through 1981/82. It was increased by the Danish Parliament in the summer of 1981 to 25 percent for years of assessment beginning with 1982/83. The credit partially alleviates the double taxation of distributed profits earned by Danish companies. The 15-percent credit in effect before year of assessment 1982/83 offset approximately 25 percent of the Danish corporation tax paid on distributed profits. (The rate of the Danish corporation tax on distributed and undistributed profits has been approximately 40 percent since before the introduction of the imputation system. It is scheduled to increase to 50 percent for years of assessment beginning with 1985/1986.)

For practical reasons, the credit is allowed under Danish law for dividends deriving from corporate profits on which the payor corporation has not paid corporation tax or on which the payor corporation paid tax before the imputation system became operative. In such cases, the payor corporation must pay a "compensatory" tax in an amount corresponding roughly to the amount of the credit. The payor corporation must keep a distribution of dividends account recording the amount that the payor corporation may distribute as a dividend without triggering compensatory tax.

The legislation introducing the imputation system did not change the prior rule of Danish law that Danish parent companies do not include in taxable profits dividends received from Danish resident subsidiaries if the parent holds at least 25 percent of the share capital or cooperative share capital of the subsidiary during the whole of the taxable year in which the dividends are received. Because of this rule, no tax credit is attached to such dividends.

Under Danish law, the imputation credit either is applied against a resident shareholder's Danish income tax liability or, if the credit exceeds such liability, is refunded to the shareholder. Shareholders who have no Danish tax liability obtain a refund on demand. The dividend subject to tax is "grossed up" by the amount of the credit; that is, a Danish shareholder is required to include in taxable income the amount credited or refunded to him as well as the amount of the cash dividend. For example, if a Danish shareholder receives a cash dividend of $100 from a Danish company, the shareholder includes in income $125 and receives a tax credit or refund of $25.

In the absence of a tax treaty, no imputation credit is allowed by Denmark with respect to dividends paid to nonresidents of Denmark. In addition, dividends from a Danish subsidiary are taxed by Denmark when paid to a nonresident parent company (as opposed to a resident parent company) owning at least 25 percent of the share capital of the subsidiary. Thus, a higher tax burden is imposed on dividends paid to nonresident shareholders than is imposed on dividends paid to Danish resident shareholders. The proposed treaty and protocol substantially reduce, although they do not eliminate, this disparity.

Under the proposed treaty's imputation credit rules, dividends paid by a Danish resident company to, and beneficially owned by, a U.S. direct investor (a U.S. company which holds directly at least 25 percent of the share capital of the payor company) are distinguished from dividends paid by a Danish resident company to a U.S. portfolio investor (a U.S. company owning less than a 25 percent share capital interest in the payor company or any noncorporate U.S. resident). A U.S. direct investor is entitled to a credit equal to five percent of the gross amount of dividends paid to it by a Danish resident company. Denmark may charge a U.S. direct investor a tax on the aggregate amount of the dividends and the tax credit at a rate not exceeding five percent. A U.S. portfolio investor is entitled to a credit equal to 15 percent of the gross amount of dividends paid to it by a Danish resident company. Denmark may charge a U.S. portfolio investor a tax on the aggregate amount of the dividends and the tax credit at a rate not exceeding 15 percent. The five and 15 percent treaty tax rates are the reduced rates provided elsewhere in the dividend article and discussed above.

Subject to exceptions discussed below, the credit and reduced tax rates provided by this article result in an effective Danish tax rate on dividends paid by Danish resident companies to U.S. direct investors of one-quarter of one percent and an effective Danish tax rate on dividends paid by Danish resident companies to U.S. portfolio investors of 2.25 percent. For example, a dividend of $100 paid by a Danish resident company and beneficially owned by a U.S. direct investor will carry with it a credit of $5. The aggregate amount of the dividend and the credit, $105, will be subject to Danish withholding tax not to exceed five percent, or $5.25. The net dividend received will be $99.75. In the absence of the credit, the net dividend would be $95 ($100 gross dividend minus $5 of tax). A $100 dividend paid by a Danish resident company and beneficially owned by a U.S. portfolio investor will carry with it a credit of $15. The aggregate amount of the dividend and the credit, $115, will be subject to Danish withholding tax not to exceed 15 percent, or $17.25. The net dividend received, therefore, will be $97.75. In the absence of the credit, the net dividend would be $[illegible] ($100 gross dividend less $15 of tax).

As originally drafted, the proposed treaty set the imputation credit for U.S. direct investors equal to one-third of the credit to which a Danish resident individual would have been entitled. The proposed treaty set the credit for U.S. portfolio investors equal to the credit to which a Danish resident individual would have been entitled. At the time the proposed treaty was signed, Danish law provided for a 15-percent credit for Danish residents. As indicated above, the credit was increased to 25 percent for years of assessment beginning with 1982/83. By setting the credit for U.S. direct investors at five percent of gross dividends and for U.S. portfolio investors at 15 percent of gross dividends, the proposed protocol freezes the treaty credit available to U.S. investors at the level provided by Danish law to Danish residents for years of assessment before 1982/83. Under the proposed protocol, the treaty credit will not vary with changes in the Danish statutory credit as it would have under the proposed treaty as originally drafted.

Definition of dividends

Like the U.S. model treaty, the proposed treaty defines dividends as income from shares or other rights which participate in profits and which are not debt claims. Dividends also include income from other corporate rights which is subjected to the same tax treatment by the country in which the distributing corporation is resident as income from shares. Under this provision, each country may apply its rules for determining when a payment by a resident company is on a debt obligation or an equity interest.

Special rules and exceptions

The treaty's reduced rates of tax on dividends will not apply, and the dividend credit will be unavailable, if the dividend recipient has a permanent establishment (or fixed base in the case of an individual performing independent personal services) in the source country and the shareholding on which the dividends are paid is effectively connected with the permanent establishment (or fixed base). Dividends paid on shareholdings effectively connected with a permanent establishment are to be taxed as business profits (Article 7). Dividends paid on shareholdings effectively connected with a fixed base are to be taxed as income from the performance of independent personal services (Article 14).

The proposed treaty contains a general limitation on the taxation of dividends paid by corporations which are residents of the other country. Under this provision, Denmark may not impose any taxes on dividends paid by a U.S. corporation except where the dividends are paid to Danish residents or are paid on shareholdings effectively connected with a permanent establishment or fixed base in Denmark. Similarly, the United States may not impose any tax on dividends paid by a Danish corporation except where the dividends are paid to a resident or citizen of the United States or where the dividends are effectively connected with a permanent establishment or fixed base in the United States.

These exemptions apply even if the dividends consist wholly or partly of profits or income arising in the would-be taxing jurisdiction. That is, unlike the U.S. model treaty, the proposed treaty does not allow one country to tax dividends paid by a resident company of the other country solely because such dividends are from profits of its permanent establishment in the first country constituting 50 percent or more of its worldwide income. The effect of this departure from the U.S. model treaty is to exempt from U.S. tax dividends paid by a Danish company which, under Code section 861(a)(2)(B), are from sources in the United States and, thus, would otherwise be subject to the second tier withholding tax. This exemption for residents of Denmark is provided in the interest of reciprocity: Denmark does not currently collect a comparable tax on branch profits derived by U.S. companies from Denmark or on dividends paid by U.S. companies out of profits from a Danish permanent establishment.

To prevent third-country residents from using a Danish corporation to take advantage of this exemption, the article provides that the treaty's general limitation on the taxation of dividends paid to a resident of the other country does not apply if more than 50 percent of the share capital of the dividend-paying company is owned directly or indirectly by individuals who are not residents of the same country as the dividend-paying company and if the dividend-paying company was formed or availed of for purposes of taking advantage of the treaty's general limitation. Thus, the United States reserves the right to levy its tax when more than 50 percent of the share capital of a Danish company is owned by individuals who are not residents of Denmark and the U.S. competent authority determines that the Danish company was formed or availed of to take advantage of the treaty's general limitation, i.e., the Danish company is being used to divert the benefits of the treaty to persons not entitled to those benefits.

Article 11. Interest

In general, the United States imposes a 30-percent tax on U.S. source interest paid to foreign persons under the same rules that apply to dividends. However, the Tax Reform Act of 1984 repealed the tax for interest paid on certain portfolio indebtedness to nonresident alien individuals and foreign corporations. (This change was effective for interest paid on portfolio indebtedness issued after July 18, 1984, the date of enactment of the 1984 Act.) U.S. source interest, for purposes of the 30-percent tax, generally is interest on debt obligations of U.S. persons, but not interest on deposits in banks. U.S. source interest for this purpose also includes interest paid by a foreign corporation if at least 50 percent of the gross income of the foreign corporation, in the prior three-year period, was effectively connected with a U.S. trade or business of that corporation. The tax imposed on the latter interest is often referred to as the "second tier" withholding tax. The Committee understands that Denmark does not presently impose a tax on interest derived by nonresidents.

The proposed treaty generally provides that interest derived and beneficially owned by a resident of a country may be taxed only by that country. Thus, the proposed treaty generally exempts from the U.S. 30-percent tax on U.S. source interest paid to foreign persons, interest paid to Danish residents, and exempts from any similar Danish taxes that might be imposed in the future interest paid to U.S. residents. These reciprocal exemptions are similar to those provided in the present treaty and in the U.S. model treaty.

The exemptions apply only if the interest is beneficially owned by a resident of one of the countries. Accordingly, they do not apply if the recipient of the interest is a nominee for a nonresident. In addition, the exemptions will not apply if the recipient has a permanent establishment or fixed base in the source country and the debt claim is effectively connected with the permanent establishment or fixed base. In that event, the interest will be taxed as business profits (Article 7) or income from the performance of independent personal services (Article 14).

The proposed treaty, as amended by the protocol, addresses the issue of non-arm's-length interest charges between related parties (or parties having an otherwise special relationship) by holding that the amount of interest for purposes of applying this article will be the amount of arm's-length interest. Any amount of interest paid in excess of the arm's-length interest, for whatever reason, will be taxable according to the laws of each country, taking into account the other provisions of the proposed treaty. For example, excess interest paid to a parent corporation may be treated as a dividend under local law and thus be entitled to the benefits of Article 10 of the proposed treaty.

The proposed treaty defines interest as income from debt claims of every kind, whether or not secured and whether or not carrying a right to participate in profits. In particular, it includes income from government securities and from bonds or debentures, including premiums or prizes attaching to bonds or debentures. Penalty charges for late payment are not interest for purposes of the proposed treaty.

The proposed treaty does not prevent the United States from imposing its second tier withholding tax on interest paid by a Danish resident which, under Code section 861(a)(1)(C), is from sources in the United States, provided the recipient is a third-country resident.

Article 12. Royalties

Under the same system that applies to dividends and interest, the United States imposes a 30-percent tax on U.S. source royalties paid to foreign persons. Royalties are from U.S. sources if they are for the use of property located in the United States. U.S. source royalties include royalties for the use of or the right to use intangibles in the United States. Such royalties include motion picture royalties. The Committee understands that Denmark does not presently impose a withholding tax on royalties derived by nonresidents

The proposed treaty provides that royalties derived and beneficially owned by a resident of a country generally may be taxed only by that country. Thus, the proposed treaty generally exempts from the U.S. 30-percent tax on U.S. source royalties paid to foreign persons royalties paid to Danish residents, and exempts from any similar Danish taxes that might be imposed in the future royalties paid to U.S. residents. These reciprocal exemptions are similar to those provided in the present treaty and in the U.S. model treaty.

The exemptions apply only if the royalty is beneficially owned by a resident of the other country; they do not apply if the recipient of the royalty is a nominee for a nonresident. In addition, the exemptions will not apply where the recipient is an enterprise with a permanent establishment in the source country or an individual performing personal services in an independent capacity through a fixed base in the source country, and the property giving rise to the royalty is effectively connected with the permanent establishment or fixed base. In that event, the royalties will be taxed as business profits (Article 7) or income from the performance of independent personal services (Article 14).

The proposed treaty, as amended by the proposed protocol, addresses the issue of non-arm's-length royalties between related parties (or parties having an otherwise special relationship) by holding that the amount of royalties for purposes of applying this article will be the amount of arm's-length royalties. Any amount of royalties paid in excess of the arm's-length royalty, for whatever reason, will be taxable according to the laws of each country, taking into account the other provisions of the proposed treaty. For example, excess royalties paid to a parent corporation may be treated as a dividend under local law and thus be entitled to the benefits of Article 10 of the proposed treaty.

Royalties are defined to mean payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work (excluding cinematographic films and films and tapes used for radio or television broadcasting), any patent, trademark, design or model, plan, secret formula or process, or other similar right or property, or for information concerning industrial, commercial or scientific experience. This definition is the same as under the U.S. model treaty except that, under the U.S. model, gains from the alienation of a right or property which are contingent on the productivity, use, or disposition of such right or property are expressly included in the definition. Under Danish law, these gains are treated as capital gains and, in accordance with the capital gains provision of the proposed treaty (Article 13), will be taxable only in the country of residence. Under U.S. law, these gains are generally treated as royalties and, hence, under this royalties article, will generally be taxable only in the country of residence of the beneficial owner. Thus, the result is generally the same whether such gains are taxed under Article 12 or 13.

Income from the rental or licensing of cinematographic films and films and tapes used for radio or television broadcasting is treated as business profits under the proposed treaty (Article 7).

Article 13. Capital Gains

Generally, gain realized by a nonresident alien or a foreign corporation from the sale of a capital asset is not subject to U.S. tax unless the gain is effectively connected with the conduct of a U.S. trade or business or, in the case of a nonresident alien, he is physically present in the United States for at least 183 days in the taxable year. However, under the Foreign Investment in Real Property Tax Act of 1980, as amended, a nonresident alien or foreign corporation is taxed by the United States on gain from the sale of a U.S. real property interest as if the gain were effectively connected with a trade or business conducted in the United States. "U.S. real property interests" include interests in certain corporations holding U.S. real property.

Under the proposed treaty, as amended by the proposed protocol, gains from the disposition of real property may be taxed in the country where the real property is situated. Under the proposed protocol, real property situated in the United States and real property situated in Denmark are defined separately. Real property situated in the United States includes real property located in the United States for the purpose of the real property article (Article 6). It also includes "U.S. real property interests." The latter inclusion allows the United States to tax transactions of Danish residents taxable under the Foreign Investment in Real Property Tax Act of 1980. Real property situated in Denmark includes real property located there for the purpose of the real property article and interests in such property.

Gains from the sale or exchange of ships or aircraft operated by an enterprise of one country in international traffic, and gains from the sale or exchange of movable property pertaining to the operation of such ships or aircraft are taxable only in the country of residence of that enterprise.

The proposed protocol provides that gains derived by an enterprise of one country from the deemed alienation of an installation, drilling rig, or ship used for the exploration for or exploitation of oil and gas resources are taxable only in the country of residence of that enterprise. Thus, if a U.S. company, for example, withdraws its drilling rigs from Danish waters, Denmark will not deem that company to have disposed of the rigs and will not impose a tax, sometimes called a "balancing charge", on any deemed gain. This provision is not included in the U.S. model treaty or in the present treaty.

Gains from the alienation of movable property which forms part of the business property of a permanent establishment which an enterprise of one country has or had in the other country, or gains from the alienation of movable property pertaining to a fixed base available to a resident of one country in the other country for the purpose of performing independent personal services, including gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such a fixed base, may be taxed in that other country.

Gains from the alienation of any property other than that discussed above will be taxable under the proposed treaty only in the country where the alienator is a resident.

Article 14. Independent Personal Services

The United States taxes the income of a nonresident alien at the regular graduated rates if the income is effectively connected with the conduct of a trade or business in the United States by the individual (See discussion of U.S. taxation of business profits under Article 7 (Business Profits).) The performance of personal services within the United States can be a trade or business within the United States (sec. 864(b)).

The proposed treaty limits the right of a country to tax income from the performance of personal services by a resident of the other country. Under the proposed treaty (unlike the present treaty), income from the performance of independent personal services (i.e., services performed as an independent contractor, not as an employee) is treated separately from income from the performance of dependent personal services.

Income from the performance of independent personal services in one country by a resident of the other country will be exempt from tax in the country where the services are performed (the source country) unless the individual performing the services has a fixed base regularly available to him in that country for the purpose of performing the services. In that case, the source country can tax only that portion of the individual's income which is attributable to the fixed base.

However, income from services rendered in one country as a member of the board of directors of a company resident in that country by a resident of the other country is not subject to this article. Such income is treated separately under Article 16 (Directors' Fees). For purposes of this article, independent personal services generally include all independent activities, not merely those of persons in professions such as physicians, lawyers, engineers, architects, dentists, and accountants. Services performed as a partner in a partnership are included where the partner receives the income and bears the losses arising from the services.

The proposed treaty generally provides a broader exemption from source country tax for income from independent personal services than the present treaty provides for income from labor and personal services. Generally, under the present treaty, an exemption from tax in one country is available to a resident of the other country only if his stay in the first country does not exceed 180 days and the services he performs there are for a resident of the country of which he is a resident. If the services are not performed for such a person, an exemption under the present treaty is available only if the service provider is temporarily present in the first country for not more than 90 days and the compensation received for the services does not exceed $3,000. On the other hand, the present treaty does not contain the fixed base limitation found in the proposed treaty; under the present treaty, a fixed base maintained in a country for the purpose of performing services does not necessarily cause taxation of those services in that country.

The exemption from source country tax provided in the proposed treaty for independent personal services income is similar to that contained in the U.S. model treaty.

The taxation of income from dependent personal services is governed by Article 15.

Article 15. Dependent Personal Services

Under the Code, the income of a nonresident alien from the performance of personal services in the United States is not taxed if the individual is not in the United States for at least 90 days during a taxable year, the compensation does not exceed $3,000, and the services are performed as an employee of a foreign person not engaged in a trade or business in the United States or they are performed for a foreign office or place of business of a U.S. person.

Under the proposed treaty, income from services performed as an employee in one country (the source country) by a resident of the other country will be taxable only in the country of residence if three requirements are met: (1) the individual is present in the source country for fewer than 184 days during the taxable year concerned; (2) his employer is not a resident of the source country; and (3) the compensation is not borne by a permanent establishment or fixed base of the employer in the source country.

The proposed treaty provides that compensation derived by an employee as a member of the crew of a ship or aircraft operated in international traffic by an enterprise of one country may be taxed in that country. This provision differs from the corresponding provision of the U.S. model treaty which permits taxation only in the country where the employee is a resident.

Remuneration of a Danish resident from employment aboard an aircraft operated in international traffic by the Scandinavian Airlines System consortium may be taxed in Denmark only.

This article is modified in some respects for directors' fees (Article 16), pensions (Article 19), and compensation as a government employee (Article 20). The present treaty rules for taxation of labor and personal services income are discussed under under Article 14, above.

Article 16. Directors' Fees

Under the proposed treaty, directors' fees and similar payments derived by a resident of one country for services rendered in the other country as a member of the board of directors of a company which is a resident of that other country may be taxed in that other country.

This treaty rule for directors' fees differs from that of the U.S. model treaty. The U.S. model treats directors' fees as personal service income or distributed profits. Under the U.S. model treaty (and the proposed treaty), the country where the recipient resides generally has primary taxing jurisdiction over personal service income and the source country tax on distributed profits is limited.

Article 17. Limitation on Benefits

The proposed treaty, as amended by the proposed protocol, contains a provision that is intended to limit the benefits of the treaty to persons who are entitled to them by reason of their residence in the United States or Denmark.

The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Denmark as they apply to residents of the two countries. At times, however, residents of third countries attempt to use a treaty. This use is known as "treaty shopping." Under certain circumstances, and without appropriate safeguards, the nonresident is able to secure these benefits by establishing a corporation (or other entity) in one of the countries which, as a resident of that country, is entitled to the benefits of the treaty. Additionally, it may be possible for the third-country resident to repatriate funds to that third country from the entity under favorable conditions (i.e., it may be possible to reduce or eliminate taxes on the repatriation) either through relaxed tax provisions in the distributing country or by passing the funds through other treaty countries (essentially, continuing to treaty shop), until the funds can be repatriated under favorable terms.

The proposed treaty, as amended by the proposed protocol, contains provisions intended to limit the use of the treaty to bona fide residents of the two countries. This is accomplished by providing that a person other than an individual (for example, a corporation, partnership, trust, or other business organization) is not entitled to the benefits of the treaty unless it satisfies an ownership/interest payment test, a public company test, or a good business purpose test.

Under the ownership/interest payment test, more than 50 percent of the beneficial interest (in the case of a company, more than 50 percent of the number of shares of each class of shares) in that entity must be owned directly or indirectly by any combination of one or more individual residents of Denmark or the United States, citizens of the United States, certain publicly traded companies (as described in the discussion of the public company test below), the countries themselves, or the political subdivisions or local authorities of the countries. In addition, in the case of the treaty benefits conferred under Articles 10 (Dividends), 11 (Interest), 12 (Royalties), or 22 (Other Income), no more than 50 percent of the gross income of the entity may be used to make interest payments, directly or indirectly, to persons or entities other than those just named. The ownership/interest payment test would, for example, deny the treaty reduction of U.S. withholding tax on U.S. source dividends, interest, and royalties to a Danish company receiving such U.S. source income that is owned by individual residents of a third country or that pays out most of its gross income as interest on debt owed to individual residents of a third country. Payments will be considered to be made under the interest payment branch of the test with respect to an original issue discount obligation when interest accrues for Danish tax deduction purposes.

Under the public company test, a company that is a resident of Denmark or the United States and that has substantial and regular trading in its principal class of stock on a recognized stock exchange in Denmark or the United States is entitled to the benefits of the treaty regardless of where its actual owners reside or the amount or destination of interest payments it makes. The term "recognized stock exchange" includes the NASDAQ System owned by the National Association of Securities Dealers, Inc. in the United States; any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934; the Copenhagen Stock Exchange; and any other stock exchange agreed upon by the competent authorities of the two countries.

Treaty benefits will be available under the proposed treaty to an entity that is a resident of the United States or Denmark, the ownership/interest payment and public company tests notwithstanding, if it is determined that the establishment, acquisition, and maintenance of the entity, and the conduct of its operations, did not have as one of its principal purposes the obtaining of such treaty benefits. Accordingly, treaty benefits generally will not be limited if there was no treaty shopping motive for forming an entity and if its operation does not have as one of its principal purposes the obtaining of treaty benefits. Thus, the burden of overcoming the treaty shopping rule, as under U.S. tax law generally, is on the taxpayer claiming benefits.

The proposed treaty contains a rule not found in the U.S. model or in most recent U.S. income tax treaties that requires consultation between the competent authorities upon invocation of this anti-treaty shopping article. However, notes exchanged when the proposed protocol was signed memorialize the countries' understanding that a failure of their competent authorities to consult with each other, as required, will not result in a granting of treaty benefits that would otherwise be denied. In the notes, the two countries expressed their willingness to review the administration of this anti-treaty shopping article after a reasonable period of time and, if desirable and appropriate, to amend the article to provide that an agreement of the countries' competent authorities is a precondition of denying treaty benefits.

Article 18. Artistes and Athletes

The proposed treaty contains a separate set of rules that apply to the taxation of income earned by entertainers (such as theater, motion picture, radio, or television "artistes" or musicians) and athletes. These rules apply notwithstanding the other provisions dealing with the taxation of income from personal services (Articles 14 and 15) and are intended, in part, to prevent entertainers and athletes from using the treaty to avoid paying any tax on their income earned in one of the countries.

Under this article, one country may tax an entertainer who is a resident of the other country on the income from his personal services as an entertainer in the first country during any year in which the gross receipts derived by him from such activities, including his reimbursed expenses, exceed $3,000 or its equivalent in Danish kroner. (This figure is unchanged from the existing treaty; the comparable amount in the U.S. model treaty is $20,000.) Thus, if a Danish entertainer maintained no fixed base in the United States and performed (as an independent contractor) for one day of a taxable year in the United States for total compensation of $2,000, the United States could not tax that income. If, however, that entertainer's total compensation were $4,000, the full $4,000 (less appropriate deductions) would be subject to U.S. tax. As in the case of the other provisions dealing with personal services income, this provision does not bar the country of residence or citizenship from also taxing that income (subject to a foreign tax credit).

In addition, the proposed treaty provides that where income in respect of personal services performed by an entertainer or athlete accrues not to the entertainer or athlete, but is diverted to another person or entity, that income will be taxable by the country in which the services are performed. (This provision applies notwithstanding the business profits and personal service articles (Articles 7, 14, and 15)). This provision is intended to prevent highly paid performers and athletes from avoiding tax in the country in which they perform by routing the compensation for their services through a third entity such as a personal holding company or a trust located in a country that would not tax the income.

Article 19. Pensions, Etc.

Under the proposed treaty, pensions and other similar remuneration beneficially derived by a resident of either country in consideration of past employment are subject to tax only in the recipient's country of residence. (This rule does not apply in the case of pensions paid to a resident of one country attributable to services performed for government entities of the other unless the resident of the first country is also a citizen of the first country (Article 20 (Government Service)).

Social security payments and other public pensions paid by one country to an individual who is a resident of the other country or to a U.S. citizen will be taxable only in the paying country. This rule, which is not subject to the saving clause, exempts U.S. citizens and residents from U.S. tax on Danish social security payments. Conversely, under this rule, only the United States may tax U.S. social security payments to persons residing in Denmark. The rule thus safeguards the United States' right under the Social Security Amendments of 1983 to tax a portion of U.S. social security benefits received by nonresident individuals, while protecting any such individuals residing in Denmark from double taxation.

The proposed treaty also provides that annuities may be taxed only in the country of residence of the person who beneficially derives them. Annuities are defined as a stated sum paid periodically at stated times during life or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services).

If two conditions are met, contributions to a pension plan recognized for tax purposes in one country, made by or for an individual resident of the other country who is not a citizen of that second country, will be treated the same way for tax purposes in the second country as contributions made to a pension plan recognized for tax purposes in the second country would be treated in the second country. The two conditions are that the individual was contributing to the pension plan before he became a resident of the second country and the competent authority of the second country agrees that the pension plan corresponds to one it would recognize for tax purposes. This provision generally requires Denmark to allow a deduction to a U.S. citizen residing in Denmark for contributions to a pension plan recognized for tax purposes under U.S. internal law. Absent such a provision, the Committee understands that Danish administrative practice would not allow a deduction for payments to a foreign pension fund (other than those of certain countries). The saving clause does not apply to this provision.

The proposed treaty contains special rules for alimony and child support. Following the U.S. model treaty, the proposed treaty exempts alimony from tax at source. The term "alimony" is not defined in the treaty. However, the omission was not intended to imply any change in the meaning of the term from the meaning given it in the U.S. model treaty.

Child support payments made by a resident of one country to a resident of the other country (who is a child under 18 years of age) pursuant to a written separation agreement or decree of divorce, separate maintenance, or compulsory support may be taxed only in the first country under the proposed treaty. However, when such payments are made by a citizen or resident of the United States to a resident of Denmark pursuant to a Danish court decree, the payments may be taxed by Denmark and the United States must allow a deduction for the payments. Under U.S. law, child support payments are not taxable income to the recipient (Code sec. 71(b)) and the payor may not deduct such payments; under Danish law, on the other hand, child support payments are taxable income to a child 15 years old or older and the payor may deduct such payments provided they are made to a child 18 years old or younger. This treaty rule is not superseded by the saving clause. The taxation of child support payments made to a child 18 years old or older is governed by Article 22 (Other Income). See discussion under "Committee Comments," above.

Article 20. Government Service

The proposed treaty contains the standard provision that generally exempts the wages of employees of one of the countries from tax by the other country.

Under the proposed treaty, remuneration, other than a pension, paid by a country or one of its political subdivisions or local authorities to an individual for services rendered to that country (or subdivision or authority) will generally be taxable in that country only. However, such remuneration will be taxable only in the other country (the country not the payor) if the services are rendered in that other country and the individual is a resident of that other country who either (1) is a citizen of that country or (2) did not become a resident of that country solely for the purpose of rendering the services. Thus, for example, Denmark would not tax the compensation of a U.S. citizen and resident who is in Denmark to perform services for the U.S. Government and the United States would not tax the compensation of a Danish citizen and resident who performs services for the U.S. Government in Denmark.

Any pension paid by, or out of funds created by, a country or one of its political subdivisions or local authorities to an individual for services rendered to that country (or subdivision or authority) will generally be taxable only in that country. However, such pensions will be taxable only in the other country if the individual is both a resident and a citizen of that other country.

In the situations described above, the U.S. model treaty allows exclusive taxing jurisdiction to the paying country, but only in the case of payments to one of its citizens.

If a country or one of its political subdivisions or local authorities is carrying on a business (as opposed to functions of a governmental nature), the provisions of Articles 15 (Dependent Personal Services), 16 (Directors' Fees), 18 (Artistes and Athletes), and 19 (Pensions, Etc.) will apply to remuneration and pensions for services rendered in connection with the business.

This provision is generally excluded from the saving clause.

Article 21. Students and Trainees

The treatment afforded students and trainees under the proposed treaty, as amended by the proposed protocol, corresponds generally to the treatment afforded them under the present treaty. Residents of one country who become students or business apprentices in the other country will be exempt from tax in the host country on payments received for their maintenance, education, or training, if they are engaged in a full-time education or training program and the payments arise from sources outside the host country. This provision is excluded from the saving clause. It closely resembles the corresponding provisions of the OECD model treaty and U.S. model treaty.

The proposed protocol deletes a provision included in the proposed treaty as originally drafted which would have allowed students and business apprentices subject to this article who are Danish residents immediately before visiting the United States to elect to be treated as U.S. residents for U.S. tax purposes. A similar provision formerly included in the U.S. model treaty has been deleted in the current U.S. model.

Article 22. Other Income

This article is a catch-all provision intended to cover items of income not specifically covered in other articles, and to assign the right to tax income from third countries to either the United States or Denmark. Thus, it applies to income from third countries as well as to income from the United States and Denmark. This article is substantially identical to the corresponding article in the U.S. model treaty.

As a general rule, items of income not otherwise dealt with in the proposed treaty which are derived by residents of either country will be taxable only in the country of residence. This rule, for example, gives the United States the sole right under the treaty to tax income sourced in a third country and paid to a resident of the United States. This article is subject to the saving clause, so U.S. citizens who are Danish residents would continue to be taxable by the United States on their third-country income, with a foreign tax credit provided for income taxes paid to Denmark.

The general rule just stated does not apply if the beneficial owner of the income (other than income from real property (Article 6)) is a resident of one country and carries on business in the other country through a permanent establishment or a fixed base, and the right or property in respect of which the income is paid is effectively connected with the permanent establishment or fixed base.

In such a case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, will apply.

In the case of Denmark, gifts will be considered "other income" under this article, except that the provisions of the gift and estate tax treaty between the United States and Denmark will apply to those gifts subject to the Danish duty on gifts.

Article 23. Relief from Double Taxation

One of the two principal purposes for entering into an income tax treaty is to limit double taxation of income earned by a resident of one of the countries that may be taxed by the other country. The United States seeks unilaterally to mitigate double taxation by generally allowing U.S. taxpayers to credit the foreign income taxes that they pay against U.S. tax imposed on their foreign source income. A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax on U.S. source income. Therefore, the foreign tax credit provisions contain a limitation that ensures that the foreign tax credit offsets U.S. tax on foreign source income only. This limitation is generally computed on a worldwide consolidated basis. Hence, all income taxes paid to all foreign countries are combined to offset U.S. taxes on all foreign income. Separate limitations on the foreign tax credit are provided for oil extraction income, DISC dividends, FSC dividends, taxable income of a FSC attributable to foreign trade income, and certain interest.

A U.S. corporation that owns 10 percent or more of the voting stock of a foreign corporation may credit foreign taxes paid or deemed paid by that foreign corporation on earnings that are received as dividends (deemed paid credit) (Code sec. 902). These deemed paid taxes are included in the U.S. shareholder's total foreign taxes paid for the year the dividend is received and go into the general pool of taxes to be credited.

Unilateral efforts to limit double taxation are imperfect. Because of differences in rules as to when a person may be taxed on business income, a business may be taxed by two countries as if it were engaged in business in both countries. Also, a corporation or individual may be treated as a resident of more than one country and be taxed on a worldwide basis by both.

Part of the double tax problem is dealt with in other articles that limit the right of a source country to tax income. This article provides further relief where both Denmark and the United States will still tax the same item of income. This article is not subject to the saving clause, so that the country of citizenship or residence waives its overriding taxing jurisdiction to the extent that this article applies.

The present treaty generally provides for relief from double taxation by each country permitting a credit against its tax for the appropriate amount of taxes paid to the other country on income from sources within that other country. The credit is provided, however, only to the extent permitted under certain domestic laws.

The proposed treaty provides separate rules for relief from double taxation for the United States and Denmark.

United States

Foreign tax credit generally

The proposed treaty, as amended by the proposed protocol, contains a provision under which the United States allows a citizen or resident a foreign tax credit for the appropriate amount of income taxes imposed by Denmark. The credit is to be computed in accordance with the provisions of and subject to the limitations of U.S. law (as those provisions and limitations may change from time to time without changing the general principles of the credit). This provision is similar to that found in many U.S. income tax treaties.

The proposed treaty, as amended by the proposed protocol, also allows the U.S. deemed paid credit to U.S. corporate shareholders of Danish companies receiving dividends in any taxable year from those companies if the U.S. company owns 10 percent or more of the voting stock of the Danish company. The credit is allowed for the appropriate amount of income taxes imposed by Denmark on the Danish company with respect to the profits out of which the dividends are paid.

The double taxation article provides that Danish income taxes covered by the treaty (Article 2 (Taxes Covered)) are to be considered income taxes for purposes of the U.S. foreign tax credit. The appropriate amount allowed as a credit is to be based on the Danish income taxes paid or accrued. The credit may not exceed the foreign tax credit limitation provided under U.S. law.

Danish hydrocarbon tax

The proposed protocol extends the proposed treaty's coverage to income taxes imposed under the recently enacted Danish Hydrocarbon Tax Act. Under the protocol, such taxes will be credited when paid or accrued by U.S. citizens or residents, subject to limitations described below. In the absence of the protocol, Danish income taxes on companies subject to the Danish Hydrocarbon Tax Act may not be fully creditable under U.S. Treasury Department regulations. The treaty credit will be available retroactively for Danish taxes paid for taxable years beginning after 1982. See discussion under "Committee Comments," above.

The Danish Hydrocarbon Tax Act was adopted in April 1982. The Act generally imposes a tax on income in connection with preliminary surveys, exploration, and extraction of hydrocarbons in Denmark. For these purposes Denmark includes its territorial sea and the Danish part of the continental shelf. The tax is levied in addition to the regular Danish income and corporate taxes and is assessed separately. However, a deduction is allowed for income and corporate taxes paid. The hydrocarbon tax is imposed on a field-by-field basis and amounts to 70 percent of the aggregate taxable income of the fields showing profits. Special deduction and allowance rules apply in computing taxable hydrocarbon income. Losses arising from other activities may not be set off against hydrocarbon income, but hydrocarbon losses may be deducted from other profits.

While it is no longer U.S. treaty policy generally to provide a credit for foreign taxes on oil and gas extraction income like the Danish hydrocarbon tax, the U.S. income tax treaties with Denmark's North Sea competitors, the United Kingdom and Norway, do so.

Under the proposed protocol, the amount of U.S. tax credit allowed for Danish income taxes paid or accrued by persons subject to the hydrocarbon tax or a substantially similar tax is subject to a special limitation. With respect to income taxes on oil and gas extraction income from oil or gas wells in Denmark, the amount of U.S. credit allowed a corporation may not exceed the amount of the income multiplied by the maximum U.S. corporate income tax rate for the year (currently 46 percent). The amount of U.S. tax credit allowed an individual with respect to income taxes on such income may not exceed the amount of the income multiplied by the individual's average U.S. tax rate with respect to the individual's entire taxable income for the year. This limitation is similar in effect to that imposed under Code sec. 907 on the amount of the foreign tax credit allowed for foreign taxes paid on foreign oil and gas extraction income although, unlike the section 907 limitation, it operates on a per-country basis. It also resembles the limitations on the U.S. foreign tax credit for taxes on foreign oil and gas extraction income that are contained in the U.S. income tax treaties with the United Kingdom and Norway.

The proposed protocol permits a limited carryback and carryover of Danish taxes on oil and gas extraction income from oil or gas wells in Denmark that, under the special limitation, cannot be credited in the year paid or accrued. These taxes may be carried to those years specified under U.S. law (the two preceding years and the five succeeding years) and credited in those years subject to the treaty's special limitation as applied in those years. An additional two-percent limitation on the amount of the carryback and carryover, included in the U.S. treaties with Norway and the United Kingdom, is omitted from the proposed protocol, reflecting the 1982 elimination from the corresponding carryback and carryover provisions of Code section 907 of the two-percent limitation (sec. 211(d), Tax Equity and Fiscal Responsibility Act of 1982).

Source rules

The proposed treaty, as amended by the proposed protocol, provides special source rules for determining whether certain income received by U.S. citizens residing in Denmark arises from sources within or outside the United States. These source rules apply under this article for the purpose of allowing relief from double taxation by the United States. They do not supersede the U.S. source rules for the purpose of internal U.S. law.

Under the special source rules, income which, in accordance with the treaty, may be taxed in Denmark (because the recipient is a resident of Denmark) and either may not be taxed in the United States or may be taxed in the United States solely because the recipient is a U.S. citizen is deemed to arise from sources outside the United States. Because the recipient is a Danish resident, Denmark will have the right to tax the income. The United States will credit the Danish tax on the income against any U.S. tax imposed by reason of a recipient's U.S. citizenship.

In the case of dividends paid by a U.S. corporation and beneficially owned by a U.S. citizen residing in Denmark, the portion of the dividends which may be taxed by the United States solely by reason of citizenship is treated as arising outside the United States, provided the recipient certifies to the competent authority of the United States that he is resident in Denmark and elects to be subject to withholding tax on the dividends under Article 10 (Dividends). In such a case, the U.S. withholding agent will withhold a tax of 15 percent from the dividends as if the recipient were a resident of Denmark who is not a citizen of the United States. The amount of tax withheld will be applied against the final U.S. tax due on the dividends. It will also be credited against the Danish tax on the dividends. In addition, credit will be allowed against the U.S. tax for the net Danish tax (after the withholding tax credit).

The special source rules do not apply to a former U.S. citizen whose loss of citizenship had as one of its principal purposes the avoidance of tax.

Denmark

U.S. tax paid by a Danish resident in accordance with the treaty (other than solely by reason of U.S. citizenship) generally may be credited against Danish tax on the Danish resident's income. U.S. tax paid by a U.S. resident company on profits out of which dividends are paid to a Danish company owning at least 25 percent of the share capital of the U.S. company may be credited, in an appropriate amount, against Danish tax on the Danish company's income. In either case, the credit is not to exceed the amount of the Danish tax, as computed before the credit, which is attributable to the income of the Danish taxpayer that is taxable in the United States. Thus, Denmark will credit U.S. tax paid by a Danish resident (other than solely by reason of U.S. citizenship) up to the amount of the Danish tax that would otherwise be imposed on the income that attracted the U.S. tax.

The proposed treaty allows Denmark to employ an "exemption with progression" method in the case of income derived by a Danish resident that is taxable in the United States under the treaty. Under the exemption with progression method such income, while exempt from Danish tax, may be taken into the Danish tax base for purposes of determining Danish tax on non-exempt income. The Danish tax so computed is reduced by the hypothetical tax attributable to the income taxable only in the United States. For example, if a Danish resident has $100 of income, $50 from Denmark and $50 of U.S. social security benefits, Denmark will determine its tax on $100 of income, and then forgive one-half ($50/$100) of that tax.

Article 24. Non-Discrimination

The proposed treaty contains a comprehensive non-discrimination article relating to all taxes of every kind imposed at the national, state, or local level. It is similar to the non-discrimination article in the U.S. model treaty and to provisions that have been embodied in other recent U.S. income tax treaties. The non-discrimination article of the proposed treaty differs from the U.S. model in protecting all legal persons deriving their status as such from the United States, not only U.S. citizens. In this regard, the non-discrimination article of the proposed treaty more closely resembles that of the OECD model treaty.

In general, under the proposed treaty, one country cannot discriminate by imposing other or more burdensome taxes (or requirements connected with taxes) on nationals of the other country than it would impose on its citizens in the same circumstances. This provision applies whether or not the nationals in question are residents of the United States or Denmark. However, for purposes of U.S. tax, a U.S. citizen who is not a resident of the United States and a Danish citizen who is not a resident of the United States are not in the same circumstances.

The proposed treaty adopts the OECD model treaty definition of "nationals." Nationals are individuals possessing the citizenship of the United States or Denmark and all legal persons deriving their status as such from the laws in force in the United States or Denmark. Under the U.S. model treaty, by comparison, only U.S. citizens qualify as U.S. nationals for purposes of obtaining non-discrimination benefits.

Under the proposed treaty, neither country may tax a permanent establishment of an enterprise of the other country less favorably than it taxes its own enterprise carrying on the same activities. Consistent with the U.S. and OECD model treaties, however, a country is not obligated to grant residents of the other country any personal allowances, reliefs, or reductions for tax purposes on account of civil status or family responsibilities which it grants to its own residents.

Each country is required (subject to the arm's-length pricing rules of Articles 9(1) (Associated Enterprises), 11(4) (Interest), and 12(4) (Royalties)) to allow its residents to deduct interest, royalties, and other disbursements paid by them to residents of the other country under the same conditions that it allows deductions for such amounts paid to residents of the same country as the payor. The term "other disbursements" is understood to include a reasonable allocation of executive and administrative expenses, research and development expenses, and other expenses incurred for the benefit of a group of related enterprises. For purposes of capital taxes, debts that are owed residents of the other country are to be deductible to the extent that they would be deductible if owed to a resident of the country of residence of the obligor.

The rule of non-discrimination also applies to enterprises of one country that are owned in whole or in part by residents of the other country. Enterprises resident in one country, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other country, will not be subjected in the first country to any taxation or any connected requirement which is other or more burdensome than the taxation and connected requirements that the first country imposes or may impose on its similar enterprises.

The non-discrimination article does not override the right of the United States to tax foreign corporations on their dispositions of U.S. real property interests since the effect of the provisions imposing such tax is not discriminatory; the election to be treated as a U.S. corporation under Code sec. 897(i) precludes the possibility of discrimination.

The saving clause (which allows the country of residence or citizenship to tax notwithstanding certain treaty provisions) does not apply to the non-discrimination article.

Article 25. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision which authorizes the competent authorities of the United States and Denmark to consult together to attempt to alleviate individual cases of double taxation not in accordance with the proposed treaty. The saving clause of the proposed treaty does not apply to this article, so that the application of this article may result in waiver (otherwise mandated by the proposed treaty) of taxing jurisdiction by the country of citizenship or residence.

Under this article, a resident of one country who considers that the action of one or both of the countries will cause him to pay a tax not in accordance with the treaty may present his case to the competent authority of the country of which he is a resident or citizen. The competent authority will then make a determination as to whether the objection appears justified. If the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, then that competent authority will endeavor to resolve the case by mutual agreement with the competent authority of the other country, with a view to the avoidance of taxation which is not in accordance with the treaty. This provision requires the waiver of the statute of limitations of either country so as to permit the issuance of a refund or credit notwithstanding the statute of limitations. The provision, however, does not authorize the imposition of additional taxes after the statute of limitations has run.

The competent authorities of the countries are to endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the treaty. They may also consult together for the elimination of double taxation in cases not provided for in the treaty.

Unlike the U.S. model treaty, the proposed treaty does not enumerate particular matters to which the competent authorities might agree. However, it is intended that, as under the U.S. model, the competent authorities will be authorized to agree to matters including the allocation of income, deductions, credits, or allowances, the determination of the source of income, and the common meaning of terms.

The proposed treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of this mutual agreement article. This provision makes clear that it is not necessary to go through diplomatic channels in order to discuss problems arising in the application of the treaty. It also removes any doubt as to restrictions that might otherwise arise by reason of the confidentiality rules of the United States or Denmark.

Article 26. Exchange of Information

This article forms the basis for cooperation between the two countries in their attempts to deal with avoidance or evasion of their respective taxes and to obtain information so that they can properly administer the treaty. The proposed treaty provides for the exchange of information which is necessary to carry out the provisions of the proposed treaty or of the domestic laws of the two countries concerning taxes to which the treaty applies insofar as the taxation under those domestic laws is not contrary to the treaty. The exchange of information is not restricted by Article 1 (General Scope). Therefore, third-country residents will be covered. In addition, the exchange of information applies to all national taxes imposed by either country, whether or not otherwise covered by the treaty.

Any information exchanged is to be treated as secret in the same manner as information obtained under the domestic laws of the country receiving the information. Under the proposed protocol, exchanged information may be disclosed only to persons or authorities (including courts and administrative bodies) involved in assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes to which the treaty applies. Such persons or authorities can use the information for such purposes only. Persons involved in the administration of taxes include legislative bodies involved in oversight of the administration of taxes, including their agents such as, for example, the U.S. General Accounting Office, with respect to such information as they consider to be necessary to carry out their oversight responsibilities.

The proposed treaty contains limitations on the obligations of the countries to supply information. A country is not required to carry out administrative measures at variance with the law and administrative practice of either country, or to supply information which is not obtainable under the laws or in the normal course of the administration of either country, or to supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

Upon an appropriate request for information, the requested country is to obtain the information to which the request relates in the same manner and to the same extent as if its tax were at issue. A requested country is to use its subpoena or summons powers or any other powers that it has under its own laws to collect information requested by the other country. It is intended that the requested country may use those powers even if the requesting country could not under its own laws. Thus, it is not intended that the provision be strictly reciprocal. For example, once the Internal Revenue Service has referred a case to the Justice Department for possible criminal prosecution, the U.S. investigators can no longer use an administrative summons to obtain information. If, however, Denmark could still use administrative processes to obtain requested information, it would be expected to do so even though the United States could not. The United States could not, however, tell Denmark which of its procedures to use.

Where specifically requested by the competent authority of one country, the competent authority of the other country is to provide the information in the form requested. Specifically, the competent authority of the second country will provide depositions of witnesses and copies of unedited documents (including books, papers, statements, accounts, and writings) to the extent that they can be obtained under the laws and practices of the second country in the enforcement of its own tax laws.

Article 27. Administrative Assistance

This article provides for administrative cooperation between the two countries in enforcing and collecting income tax claims. It is carried over from the present treaty with minor modifications. The article is also similar to a provision included in the exchange of information article of the U.S. model treaty, but is broader in scope and more detailed than the U.S. model treaty provision.

The proposed treaty provides that the countries are to undertake to assist and support each other in collecting the taxes to which the treaty applies, including interest and other additions to such taxes. The treaty specifies that each country may accept for enforcement and may collect revenue claims of the other country which have been finally determined. The accepting country is to enforce and collect such revenue claims in accordance with the laws applicable to the enforcement and collection of its own taxes. When one country applies to the other for assistance in enforcing a revenue claim, its application must include a certification that the taxes have been finally determined under its own laws.

Notes exchanged by the United States and Denmark at the time the treaty was signed provide that a revenue claim is "finally determined" for these purposes when all rights of administrative appeal (except, in the case of Denmark, the right to revision by exceptional procedure) have lapsed or been exhausted, and the applying country has the right under its internal law to enforce and collect the revenue claim. However, if the revenue claim is before a judicial tribunal of the applying country at any time, it is finally determined when all rights of judicial appeal have lapsed or been exhausted and the judicial decision has become final. This definition was included in the exchanged notes at the U.S. Treasury Department's request in order to resolve practical difficulties which the Internal Revenue Service has encountered in interpreting when a revenue claim has been "finally determined" in the present treaty and in treaties with other countries containing this language.

The administrative assistance provided for in this article is not to be accorded with respect to citizens, companies, or other entities of the country whose assistance is requested except as is necessary to insure that the treaty exemptions or rate reductions granted to those persons are not enjoyed by persons not entitled to those benefits.

Article 28. Diplomatic Agents and Consular Officers

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the privileges of diplomatic agents or consular officials under the general rules of international law or the provisions of special agreements. Accordingly, the treaty will not defeat the exemption from tax which a host country may grant to the salary of diplomatic officials of the other country. The saving clause does not apply to this article, so that, for example, U.S. diplomats who are considered Danish residents will not be subject to Danish tax.

Article 29. Entry Into Force

The governments of the countries are to notify each other through diplomatic channels when the constitutional requirements for entry into force of the proposed treaty have been satisfied. Upon receipt of the latter of the notifications, the proposed treaty will enter into force. Identical rules for entry into force apply to the proposed protocol.

These entry-into-force rules differ from those of the U.S. model treaty which requires the countries to exchange instruments of ratification as soon as possible and provides for entry into force upon that exchange. The reason for the variation is that Danish law, unlike the U.S. Constitution, does not require legislative ratification of certain international agreements concluded by the government. The Danish Parliament may delegate to the Danish executive branch the power to conclude binding international agreements and has done so in the case of agreements to avoid double taxation.

With respect to taxation of dividends at source, the proposed treaty and proposed protocol will be effective for dividends paid or credited on or after the first day of the second month next following the date or dates on which the treaty and protocol enter into force. As originally drafted, the treaty would have been effective for dividends paid or credited on or after the first day of January next following the date on which the proposed treaty entered into force. With respect to the credits against U.S. tax allowed for Danish taxes under the proposed treaty, as amended by the proposed protocol, the treaty and protocol, after entering into force, will be effective retroactively for taxable years beginning after 1982. With respect to other income, the proposed treaty and proposed protocol will be effective beginning on or after the first day of January next following the date on which the treaty and protocol enter into force.

The existing treaty is to be phased out as the proposed treaty becomes effective. When the proposed treaty becomes fully effective, the existing treaty will terminate. However, where any provision of the present treaty would have afforded any person greater tax relief than the proposed treaty, that provision of the present treaty will continue to have effect for one year after the date on which the provisions of the proposed treaty would otherwise have first had effect. For example, the present treaty provides a two-year exemption from source country taxation for visiting teachers. An individual who qualifies under the present treaty for that exemption and who had claimed it for only one year when the proposed treaty took effect could continue to claim it for one year after the date on which the proposed treaty would otherwise apply.

Article 30. Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after five years from its entry into force by giving at least six months prior notice of termination through diplomatic channels. A termination will be effective with respect to income of taxable years beginning (or, in the case of taxation at source, amounts paid or credited) on or after the first day of January next following the date of termination specified in the notice of termination.

Exchange of Notes

At the signing of the proposed treaty, notes were exchanged dealing with four issues. First, the notes provide that all income derived from the operation in international traffic of aircraft by the New York corporation Scandinavian Airlines System, Inc. (SAS, Inc.) will be treated as income of the Scandinavian Airlines System consortium (SAS) for purposes of the exemption from U.S. tax provided in Article 8 (Shipping and Air Transport). The notes confirm that SAS established SAS, Inc. in 1946 to avoid the problems inherent in operating in the United States through a consortium, and that SAS, Inc. acts as SAS's agent. This note is substantially identical to a note exchanged by the United States and Norway upon the signing of their income tax treaty.

Second, the notes state that the treaty may be extended either in its entirety or with any necessary modifications to any territory or U.S. possession which imposes taxes substantially similar to those covered by the treaty. Any such extension will enter into force in accordance with the countries' respective constitutional procedures.

Third, the notes memorialize the countries' understanding that Articles 7 (Business Profits) and 24 (Non-Discrimination) will not prevent Denmark from continuing to tax Danish permanent establishments of U.S. insurance companies pursuant to section 12, paragraph 3 of Denmark's Company Tax Law. The Committee understands that under that provision of Danish law, Denmark attributes to the Danish permanent establishment of a foreign insurer that portion of the company's profits which its Danish gross premium income bears to its total gross premium income. The foreign insurer is given an opportunity to disprove the amount of profit attributed by this method if the result is inaccurate.

Fourth, the notes specify when a revenue claim is considered to be "finally determined," as the term is used in Article 27 (Administrative Assistance). This note is discussed in more detail under Article 27 above.

Protocol

A proposed protocol modifying the proposed treaty was signed on August 23, 1983. At the signing of the protocol, notes were exchanged clarifying the implementation of certain provisions of the proposed treaty.

Explanation

The proposed protocol makes a number of significant changes in provisions of the proposed treaty. The protocol specifies that the Danish imputation tax credit allowed to certain U.S. investors in Danish resident corporations under Article 10 (Dividends) of the proposed treaty will be equal to 15 percent of the gross dividend paid to U.S. portfolio investors and five percent of the gross dividend paid to U.S. direct investors. In Article 10 as originally drafted, the credit available to U.S. investors was expressed instead as a proportion of the credit available to Danish resident individuals under Danish internal law. Under the treaty as originally drafted, then, the imputation credit available to U.S. shareholders would have varied with changes in the Danish statutory credit. The protocol freezes the credit at the rates that would have applied under the proposed treaty at the time it was signed. The protocol modifies the dividend article in other respects as well.

The proposed protocol extends the treaty's coverage to the recently enacted Danish hydrocarbon tax (and the U.S. excise tax with respect to private foundations). The double taxation relief provisions of the proposed treaty (Article 22) are amended to provide a foreign tax credit for the taxes paid by companies subject to the hydrocarbon tax, subject to a special limitation under which the amount of the credit in a taxable year for such tax is limited to the amount of U.S. tax on Danish oil and gas extraction income. The protocol also makes other changes in the double taxation relief provisions.

The proposed protocol replaces Article 17 of the proposed treaty (Investment or Holding Companies) with a more far-reaching anti-abuse article denying treaty benefits to residents of third countries who establish a corporation or other entity in either Denmark or the United States for the principal purpose of obtaining treaty benefits. The protocol's anti-abuse article is less strict, however, than the corresponding provision of the 1981 U.S. model treaty. A revision of the definition of real property in the capital gains provision (Article 13) allows the United States to tax any transaction of a Danish resident taxable under the Foreign Investment in Real Property Tax Act of 1980. The protocol modifies the exchange of information provision (Article 26) to make clear that persons involved in the administration of taxes, such as the U.S. General Accounting Office, will have access to exchanged information.

The permanent establishment definition (Article 5) is modified to provide that an installation, drilling rig, or ship used for the exploration or exploitation of natural resources is not a permanent establishment if it lasts 12 months or less. The protocol also provides that the deemed alienation of such property will be taxable only in the residence country (Article 13 of the proposed treaty). These modifications will benefit U.S. drillers operating in the Danish sector of the North Sea.

As originally drafted, the proposed treaty provided an election to be treated as a U.S. resident for tax purposes to Danish students and business apprentices visiting the United States who qualified under the treaty for exemption from U.S. tax on foreign source income (Article 21). The proposed protocol eliminates this election.

The protocol provides that the proposed treaty will be effective with respect to taxation of dividends at source for dividends paid or credited on or after the first day of the second month next following the date on which the treaty enters into force (Article 29 of the proposed treaty). The protocol makes additional modifications in Articles 1 (Personal Scope), 11 (Interest), and 12 (Royalties). These modifications, and those just summarized, are discussed further in the applicable article discussions above.

Exchange of notes under the protocol

In the notes the two countries express their willingness to review the administration of the limitation of benefits provision of the proposed treaty (Article 17) after a reasonable period of time and, if desirable and appropriate, to amend that provision to provide that an agreement of the countries' competent authorities is a precondition of denying treaty benefits. The notes memorialize the countries' understanding that a failure of their competent authorities to consult with each other, as otherwise required under the limitation of benefits provision, will not result in a granting of treaty benefits that would otherwise be denied.

In connection with the change in the definition of real property made by the protocol (Article 13 of the proposed treaty), the notes confirm the definition of a U.S. real property holding corporation contained in the Code. The notes also state that, under the treaty provision granting relief from double taxation (Article 23), Denmark will allow a Danish company a tax credit for U.S. taxes paid by a U.S. corporation that pays the Danish company a dividend only when the dividend has been included in the Danish company's taxable income.

IX. TEXT OF THE RESOLUTION OF RATIFICATION

Resolved, (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention between the Government of the United States of America and the Government of the Kingdom of Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income together with a related exchange of notes, signed at Washington on June 17, 1980, and the Protocol Amending the Convention, together with an exchange of letters, signed at Washington on August 23, 1983.

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